

1 EXECUTIVE SESSION ON THE DEFICIT REDUCTION

2 WEDNESDAY, FEBRUARY 29, 1984

3 U.S. Senate

4 Senate Finance Committee

5 Washington, D.C.

6 The committee met, pursuant to recess, at 10:26 a.m., in
7 room SD-215, Dirksen Senate Office Building, the Honorable
8 Robert J. Dole (chairman) presiding.

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

12 Also present: Commissioner Roscoe Eggar, Internal
13 Revenue Service; Mr. John Chapoton, Assistant Secretary for
14 Tax Policy, and Mr. George Schieber, Deputy Assistant
15 Secretary for Tax Policy, Department of the Treasurer.

16 Also present: Mr. Roderick DeArment, Mr. Michael Stern;
17 Ms. Sheila Burke; Mr. Richard Belas; Mr. David Brockway;
18 Mr. James Wetzler; Mr. David Hardee; Mr. Harry Graham;
19 Mr. Stewart Dorsey; Mr. Robert Sernier; Mr. Nelson Sabatini;
20 Mr. Robert Helms, and Mr. John Sterling.

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1 The Chairman. Now, Rod, I wonder if you might just
2 quickly -- now we will have the blackboard; is that correct?

3 Mr. DeArment. That's correct. We've got it in black
4 and white there, where we stand.

5 The Chairman. Look on the spending side.

6 Mr. DeArment. On the spending side, we have, in our
7 committee's jurisdiction, 15.7 in total savings; 5.3 of that
8 is in the Reconciliation Bill; 10.4 is what we've done in
9 the last several days.

10 If you looked at the total, the Reconciliation being
11 21.2 and since then we've done 10.4; that would be 31.6
12 total.

13 We expect to get some CBO numbers shortly that will
14 bring those Reconciliation numbers down. They have
15 re-estimated.

16 On the tax side, we have 21.4 in Reconciliation tax
17 items in the bill that is reported out in October, and
18 yesterday we did about \$10.7 billion in the tax shelter,
19 corporate reform, and accounting abuse areas.

20 The Chairman. Now, if there was some agreement that
21 their at a 50/50/50, or 40-to-50, 40-to-50, 40-to-50 package,
22 defense cuts, nondefense spending reduction, and revenues,
23 what about the other committees? Now, Appropriations would
24 come with how much? How do we get \$50 billion in nondefense
25 discretionary?

1 Mr. DeArment. There would be --

2 The Chairman. Right now we have what?

3 Mr. DeArment. We have approximately 31.

4 The Chairman. All right. So then, if they freeze
5 spending, that's 13?

6 Mr. DeArment. That's another 13.

7 The Chairman. That's 44.

8 Mr. DeArment. Forty-four, plus, if you can get
9 something on Agriculture.

10 The Chairman. Agriculture, 3 or 4.

11 Mr. DeArment. And I don't know if you want to score
12 debt service in that total at all.

13 The Chairman. So, it's not too difficult, then, to
14 achieve the \$50 billion in nondefense spending reduction,
15 without us doing much more.

16 We still hope to get some out of the Grace Commission.

17 Mr. DeArment. Yes. We have some people meeting with
18 the CBO now to try to review those numbers.

19 The Chairman. All right, then, as I understand it, on
20 defense spending reduction, using the President's Budget,
21 they are talking about what? Forty-five billion? Between
22 40 and 50?

23 Mr. DeArment. Yes, approximately 45 billion by looking
24 at a lower growth path.

25 The Chairman. And then on the revenue side, we have

1 32.3, but we need in addition, say if we are going to
2 reach 50, we need about -- what are the add-ons? Three?
3 Five?

4 Mr. DeArment. Probably closer to 5 than 3.

5 The Chairman. And what are the Administration's?
6 Eight?

7 Mr. DeArment. The Administration has 8.

8 The Chairman. So, just assuming all those were
9 approved, you would need a gross figure of about 63 billion
10 on the revenue side.

11 Mr. DeArment. Well, when I said 5, some of what our
12 members are interested in are also in the Administration's
13 package. There would be some overlap. I would think we
14 would need --

15 The Chairman. Sixty?

16 Mr. DeArment. Yes. We might be able to get by with
17 55, 58, depending on how those add-ons play out.

18 The Chairman. I guess the point is, we don't have much
19 more to do, then. Is that right?

20 Mr. DeArment. No.

21 The Chairman. All right.

22 Now, what do we have here? There is nothing on our
23 tables. Are we supposed to have some material here?

24 Mr. DeArment. Mike, why don't you hand out the original
25 package that we have been working from.

1 (Pause)

2 The Chairman. Now, is there another sheet of possible
3 revenue options? Or are they in this sheet?

4 Mr. DeArment. Yes. On the last page we have "other
5 revenue options" listed.

6 Mr. Brockway. That last page has a couple of items
7 that were in your basic package, reaching \$50 billion against
8 the tax benefit rule and also the used real estate change in
9 depreciable life from 15 to 20 years.

10 The Chairman. Well, Senator Durenberger has asked, and
11 we will defer any consideration of postponing the financed
12 lease rules until '88. He cannot be here this morning.

13 Maybe while we are getting this other list of possible
14 options, Buck might indicate that we have taken care, I
15 think, of the low income housing problem that Senator
16 Packwood and Senator Bradley and Senator Heinz had questions
17 about.

18 Mr. Chapoton. As I understand it, the staffs of the
19 Senators and our staff have reached agreement of three points
20 on low income housing, that the related-party transactions,
21 there would be an exception targeted to resyndications of
22 low income housing to our related-party proposals. So that
23 would, in effect, allow a member of the new partnership in a
24 resyndication who was also a member of the old partnership,
25 and nevertheless the disallowance rules, related-party rules,

1 under Section 267 would not be applicable.

2 The second element would be a 3-year extension of the
3 5-year write-off of rehabilitation expenses under Section
4 167(k), which has expired. That would be a 3-year extension
5 of that.

6 And then there would be no increase in the depreciable
7 life of low-income housing in the event other changes are
8 made in depreciable life under ACRS. And that is acceptable
9 to us.

10 (Pause)

11 The Chairman. As I understand, Senator Packwood has
12 indicated that is satisfactory.

13 (Pause)

14 Mr. Chapoton. And I understand Senator Heinz -- we
15 would check with him, but his staff has signed off on this,
16 also.

17 The Chairman. Are there any other areas that you were
18 able to resolve since yesterday?

19 Mr. Chapoton. The premature accrual rule. There was
20 concern expressed on the mine reclamation, how that would
21 affect mine reclamation expenses, and how it would affect
22 nuclear decommissioning expenses.

23 We have worked with Senator Wallop's staff. Let me
24 review with you what we have proposed.

25 The Chairman. Does that also include the nuclear

1 decommissioning?

2 Mr. Chapoton. Yes.

3 Senator Chafee. Mr. Chairman, on the low-income
4 housing, that was worked out satisfactorily; but did we do
5 some good as far as stopping that loophole?

6 Mr. Chapoton. Yes, sir.

7 Senator Chafee. You know, the syndication of those
8 Section 8's has made a lot of people rich in this country.

9 Mr. Chapoton. The proposal would allow the related
10 party rules that we have proposed; that is, that a deduction
11 on one hand must be matched with income on the other where
12 they are related parties. They would not apply to low
13 income housing.

14 But the original issue discount rules would apply.

15 Senator Chafee. I am not familiar enough with all of
16 the details, but can you assure me that you think we have
17 done some good?

18 Mr. Chapoton. It is doing some good; it's not going
19 as far as we had proposed.

20 Senator Chafee. Thank you.

21 Senator Wallop. Mr. Chairman?

22 The Chairman. Senator Wallop.

23 Senator Wallop. With regard to the rules on mine
24 reclamation, I would say that we are very close, I think, to
25 an agreement on it. Where we are agreeing is not quite with

1 the deal that we had at the end of last year, but I think
2 we will probably be able to work out this arrangement to
3 the satisfaction of both the Treasury and myself.

4 The Chairman. All right. I think there are still a
5 couple of details you are working on, right?

6 Senator Wallop. There are.

7 Mr. Chapoton. The basic proposal would be, the
8 taxpayer would estimate mine reclamation expenses in the
9 year the mining is done. He would take his expenses,
10 estimate his expenses, at current costs of reclaiming the
11 mine, and then take a deduction for that amount, discounted
12 by a two and a half percent rate from that year to the
13 date the expenses would actually be expected to be incurred,
14 the two and a half percent being designed to be a real
15 interest discount rate, the fact that you use current costs
16 rather than future costs being designed to make it take out
17 inflation.

18 So, conceptually, it seems sound. As a practical matter
19 it will in effect be allowing some expenses in advance of
20 economic performance.

21 But our greatest concern is that this not be extended to
22 other areas. Mine reclamation does seem to fall into a
23 separate class, and so we can live with that.

24 The Chairman. Senator Wallop?

25 Senator Wallop. There are some minor details that are

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1 still being worked, but there is no reason to expect that
2 they won't be worked out.

3 The Chairman. Why don't we go ahead and agree that
4 we've got it worked out, and if not, you can flag it again.

5 Senator Wallop. There is no reason to expect that we
6 won't work it out, but there are still some details.

7 The Chairman. Are there any other areas that you
8 have visited with members on yesterday afternoon?

9 What about the nuclear question raised by Senator
10 Mitchell? Has that been completed?

11 Mr. Chapoton. Well, the nuclear decommissioning
12 expenses, we have given the Senator's people the proposal
13 that has been worked out on the House side. I understand
14 they have not agreed to it yet.

15 The Chairman. Well, when he arrives maybe we can get
16 into that.

17 What about any success with Senator Boren's problem?
18 He had more than one problem. One of them was the
19 prepayment, I think.

20 Mr. Chapoton. Well, I think we have not reached
21 agreement on prepaid expenses.

22 Senator Boren. As I understood, you looked at the
23 one-to-one provision and that the passive investor could not
24 borrow the money, and maybe a 180-day rule?

25 Mr. Chapoton. Yes.

1 Senator Boren. I don't see how we could go any further
2 without just saying, "Give you everything you asked for."

3 Mr. Chapoton. Well, that occurred to us, also.

4 Senator Boren. If that is your position, there is no
5 way to negotiate it.

6 Mr. Chapoton. Senator, let me say that any window
7 rule would alarm us, because I think that would imply, even
8 though you stated to the contrary, that any work done during
9 that period of time, a prepayment would be justified in
10 that.

11 I think this is not a big deal. I think it invites
12 disrespect for the tax law, because, having the rule we have
13 now, we force taxpayers to go to their counsel and trump up
14 business-purpose ideas. True, every once in a while
15 a business purpose will exist; but in the great preponderance
16 of the cases they simply get someone to write them a
17 letter that a business purpose exists, and the effect is
18 simply to defer their tax liability one year. We just don't
19 think it has any relationship to overall drilling activity,
20 and that's why we think the problem ought to be taken care
21 of. But we would be more alarmed by any type of window rule
22 in that.

23 So, I understand your position, and then that is just
24 our position.

25 Senator Boren. Well, Mr. Chairman, I would just say

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1 that I think we have offered a very reasonable compromise to
2 them; unless they are just going to completely do away with
3 the concept of prepayment, I think there are some
4 circumstances where prepayment is legitimate.

5 They are really talking as much as anything, I suppose,
6 about making an accounting change right now, and I would just
7 say that, given the state of the independent producing
8 sector, I don't think it is an exaggeration to say it is in
9 a depression in our area, and I think if you look at the
10 national rig count, I would just suspect that others that
11 have any production in their States would be finding a very
12 similar experience.

13 Our rig count, as I said earlier in our meetings, is
14 not even a third of what it was 18 months ago. The cash
15 flow into our State is down some \$2 billion a year, which
16 has caused our budget to be 18 percent in deficit in our
17 State right now, just to show the impact of it.

18 I am just very concerned. I mean, this is causing
19 people in the supply business -- we have had some 300 oil
20 related bankruptcies in Oklahoma City alone in the last
21 12 months, and I'm just afraid if you do anything else to
22 knock into the head the cash flow in this sector which is
23 so starved for it right now, that you are going to cause
24 another problem.

25 Anything that we get -- whether it comes in in November

1 or December or wherever, in terms of buying additional pipe,
2 paying rig prepayments, reserving those rigs, keeping them
3 working -- that's something that helps a little bit.

4 I would just say that I would hope we could perhaps
5 adopt the rules that I proposed as an alternative. If the
6 Treasury finds in a year or two that this has not ended all
7 of the abuse, I want to end the abuse, we can come back to
8 it.

9 There are times when you have fragile economic conditions
10 in an industry, and I think this is a time of great
11 fragility in the independent sector. It's a whole different
12 world than it was two or three years ago, in terms of the
13 economics of that industry.

14 The Chairman. I wonder if we might continue to try to
15 work something out on this.

16 Mr. Chapoton. All right.

17 Let me make it clear, Senator Boren, that the one
18 thing that would alarm us the most is a window rule. We
19 would rather drop the proposal than have a window rule.

20 Senator Boren. Are you talking about a day?

21 Mr. Chapoton. A number of days, 180 days, or --

22 Senator Boren. I thought we were putting that in
23 because we thought you might like it. That's fine. I would
24 be glad to drop that out and just leave the codification in
25 terms that it must constitute actual out-of-pocket payment,

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1 that it could not be borrowed money, in the case of passive
2 investors, that you could not have a write-off to exceed
3 the one-to-one ratio of what you actually put in, and that
4 it must have a legitimate business purpose.

5 If the Treasury felt that we ought to drop any
6 reference to time, I would be glad to drop it.

7 Mr. Chapoton. Let us discuss it a bit more. I think
8 those rules restate existing law. Perhaps one could argue
9 that you have some advantage to codifying existing law.

10 I just want to be careful that we don't do anything to
11 give a blessing in the law to prepayments because we simply
12 encourage activity.

13 I think it causes great disrespect for the tax law
14 when we see it.

15 Senator Long. Well, Mr. Chapoton, I just, personally,
16 doubt that you are correct in saying that that would have
17 a negligible impact, especially on independents. I just
18 feel that we are entitled to hear from them and get what
19 their judgment is, because I am convinced that we need the
20 energy.

21 Now, I know what happens in changes of Administration.
22 The Reagan Administration comes in and doesn't think much
23 of anything that President Carter did, including all of these
24 alternative sources of energy. So they get rid of them.

25 But if you look at what has been happening here, now,

1 these alternative energy supply things have all been shut
2 down -- almost all of them -- and now if, in the name of
3 tax reform, we proceed to shut off money that is needed to
4 drill for wells, oil and gas, you already have half of them
5 shut down, then all it takes is this mess to get a little
6 worse over there in the Persian Gulf and have them shut down
7 strait, and we are back in the same mess we were before, and
8 my impression is that we are in worse shape to take that
9 pressure now than we were before. Are we in any better
10 shape to withstand a cut-off of oil out of the Persian
11 Gulf than we were three years ago?

12 Mr. Chapoton. No, I think we are not. I think the
13 decline in drilling activity probably does leave us in worse
14 shape.

15 Senator Long. Well, I talked to Robert Anderson just
16 about a week ago, and mind you there is a guy who has served
17 in the same general shop you are in -- he was Secretary of
18 the Treasury and knows something about what this thing is
19 all about -- he was telling me that we ought to be subsidizing
20 beyond what we are doing now. We ought to find some way to
21 subsidize, putting all of these idle rigs back to work,
22 because we are going to need the energy, perhaps for national
23 survival.

24 I don't like to see us moving in the opposite direction.
25 Now, if this were part of a package where the overall effect

1 was going to be a major increase in drilling, I would be
2 enthusiastic for it. But I am concerned to see any
3 reduction.

4 I know it is hurting the State revenues of Louisiana,
5 because of less drilling, less activity. You have idle
6 people and idle equipment, and the Government needs the
7 energy -- that is, the people of the country need the
8 energy.

9 Mr. Chapoton. Senator, I don't disagree with any of
10 that. The only point I think we disagree on is whether this
11 would have any impact on the industry.

12 We now have a system, mind you, that sort of encourages
13 all sorts of contracting to take place in November and
14 December, because people are trying to shove tax deductions
15 into the earlier year. And it probably, although we
16 certainly don't have any evidence of this, would be healthier
17 for the industry if that were not the case.

18 But that is the case now. We have cases litigated on
19 whether there is a business purpose for paying a contractor
20 in advance -- and the payment of course doesn't ever come in
21 July or August; the payment always comes in December.

22 We are simply saying that is game playing; it will not
23 have any impact on the drilling activity. And that's a
24 judgment call; we don't have any hard figures to support my
25 position. But that's why we are doing it. It is a tax

1 reason.

2 We would certainly not do it if we thought it had any
3 significant effect on drilling activity.

4 Senator Long. Well now, in your experience, and you
5 have been a tax lawyer for some independents as well as I
6 guess larger producers --

7 Mr. Chapoton. Yes, sir.

8 Senator Long. -- but have you been on the end that
9 goes out and hustles up the money to do the drilling? Or
10 have you been on the end where you keep the books after
11 they do the drilling?

12 Mr. Chapoton. Both.

13 Senator Long. Both? I would just like to hear from
14 them, you know.

15 Mr. Chapoton. That's right. We have heard from them.
16 They don't like this. I think they don't submit any data
17 that it has any impact, and I think they recognize the
18 problem we are attempting to deal with, and I think
19 Senator Boren recognizes the problem we are attempting to
20 deal with. But we just have to recognize that if you leave
21 the law as it is, people simply are encouraged -- indeed,
22 the law says you should dream up a business purpose argument
23 and then claim the cash payment was necessitated by business
24 reasons.

25 Senator Long. I would just like to ask one further

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1 question.

2 Now, you would apply this to people who by your standards
3 are not in the business.

4 Mr. Chapoton. Correct, not in the business.

5 Senator Long. Now, suppose a person has substantial
6 income from mineral production, a lot of income from mineral
7 production. He is not drilling himself, but he does have
8 a very substantial income from mineral production, and he has
9 been investing it every year, everything he could save in
10 whatever he is doing plus what he makes in oil and gas. He
11 puts it back in the same thing. Now, would you regard him
12 as being in the business or not being in the business?

13 Mr. Chapoton. That would water down the approach, but
14 it would be better than nothing; that is, limit the
15 deduction to the previous oil income in this case. That
16 would be better than nothing. Yes, sir.

17 Senator Bentsen. Mr. Secretary, I think your point
18 about not just providing a window is a good point. We
19 shouldn't do that. But I do think Senator Boren has made
20 some proposals that will be helpful in trying to correct
21 some of these obvious abuses.

22 But the overall situation is one where I think the timing
23 could hardly be worse in trying to take this kind of an
24 action at the present time.

25 I am one who really believes it is going to affect the

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1 drilling activity, which is already in trouble, as Senator
2 Long and Senator Boren have told you.

3 Our own city of Houston, which has been one that in
4 normal times has certainly been spared recessions, this
5 time really has one, because it is so dependent on the oil
6 and gas industry, and the service industry is in serious
7 trouble -- all kinds of bankruptcies. We have never seen
8 anything like the level of bankruptcies that you see taking
9 place in the oil service business at the present time.

10 Yet, I am also convinced that this present surplus that
11 we see in oil is going to be gone in a couple of years.

12 Mr. Chapoton. I am, too, Senator.

13 Senator Bentsen. It is terribly important that we do
14 the kind of drilling now to find those reserves, to help
15 carry us through that kind of a situation.

16 So I just frankly think the timing is wrong, and I don't
17 think we should carry it through.

18 I want to support Senator Boren in what he proposes
19 in his amendment.

20 Senator Symms. Mr. Chairman?

21 The Chairman. Yes, Senator Symms.

22 Senator Symms. I would just like to very briefly say
23 I want to support what Senator Boren is trying to do, too.
24 Now, my State is not an oil-producing State, but we want to
25 be one, and there was a lot of drilling activity going on,

1 and now there is none. Because it is in the overthrust belt,
2 they have to drill deep, and I sure would be opposed to
3 us doing anything here that is going to discourage anybody
4 from going out there and drilling oil.

5 We were hoping to become an oil-producing State by now,
6 and it has been set back already. So if we are talking about
7 changing the tax laws to make it worse, I think it is not
8 healthy for the country.

9 The Chairman. All right.

10 What we have agreed to do on this is, we haven't agreed
11 to do anything, except to talk more about it.

12 Mr. Chapoton. All right.

13 Senator Symms. Well, have you got some language over
14 there, Senator Boren?

15 The Chairman. He has some, but we are not ready to
16 proceed on it.

17 Let's turn to page 6 in this document dated February 23,
18 "Down Payment Budget Plan." I guess it is the last page.
19 Is that right, Rod?

20 Mr. DeArment. That is correct, Mr. Chairman.

21 Senator Wallop. Mr. Chairman, could I just mention
22 before we go on to those that the Treasury and I and my
23 staff and the committee staff have reached tentative
24 agreement on one of those areas, which is the retroactive
25 partnership allocation abuses. And it is my understanding

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1 that Treasury will agree to a 30-day interim closing of the
2 books.

3 Mr. Chapoton. Yes, sir.

4 Senator Wallop. I thank you, Mr. Chairman.

5 Senator Heinz. Mr. Chairman, also before we go on to
6 that, while I was otherwise engaged, the committee and the
7 Treasury adopted a package that you, Mr. Chairman, and Buck
8 and my staff and I had been working out for low income
9 housing.

10 The Chairman. Right.

11 Senator Heinz. And I know that all the members of the
12 committee are familiar with it. It is a three-part package.
13 And I just wanted to thank you, Mr. Chairman, and members
14 of the committee and the Treasury Department for your help
15 in working out that package.

16 Senator Bradley. What is that package?

17 Mr. Chapoton. That package is three points. First is
18 our rule on related-party transactions would not apply
19 in the case of a resyndication of a low-income housing
20 project. That means that expenses that might be paid from
21 one partnership to the other in the resyndication would not
22 be subject to the disallowance under the rules that would
23 otherwise apply, because they are related parties.

24 Senator Bradley. The resyndication is essentially the
25 resale of an existing structure?

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1 Mr. Chapoton. Correct.

2 Senator Bradley. How does that promote low-income
3 housing?

4 Mr. Chapoton. Well, Senator, the problem that was
5 dealt with and that HUD mentions to us is the distressed
6 project, that they want somebody else to take over the
7 project to maintain it, and they are always concerned that
8 if they don't the project will simply be abandoned.

9 Senator Heinz. More to the point, there are in HUD's
10 inventory right now 236 low-income housing projects that
11 have failed that are in receivership, in effect.

12 I happen to have leased one that I recently visited in
13 Pennsylvania, the Pine Tree Manor in Newcastle, Pennsylvania.

14 Senator Bradley. What HUD program? Section 8? Section
15 236?

16 Senator Heinz. This one happens to be Section 8.

17 It is highly desirable that HUD not try to run them
18 from Washington, D.C., that they be resyndicated to a good
19 owner.

20 Another example involved Green Tree Village in the
21 South Hills of the City of Pittsburgh, where, once again,
22 the original owner went under. This was turned into a
23 cooperative venture, with the tenants actually taking over
24 the project. That has worked out extremely well.

25 Were we to lose all of these advantages, it would be

1 very difficult to do that.

2 Senator Bradley. So, your argument is that -- what is
3 this, the allocation rule?

4 Mr. Chapoton. This is the related-party rule. Without
5 this exception, payments from one partnership to the other
6 would be disallowed because they would be related -- the
7 deductions would be disallowed until the other side picked
8 up the income. So there will be a mismatching result under
9 that.

10 Senator Bradley. The depreciation would be disallowed?

11 Mr. Chapoton. No, depreciation would not be affected
12 by this.

13 Senator Bradley. That would not be affected?

14 Mr. Chapoton. It would not be affected, no.

15 Senator Heinz. That is a different issue.

16 Mr. Chapoton. Let me describe real quickly the other
17 two parts of this package.

18 The other would be a 3-year extension of the 5-year
19 write-off on rehabilitation expenses, which was terminated.
20 It expired, I believe, in 1983. It would be extended for
21 three years.

22 Senator Bradley. It expired in 1983, pursuant to what
23 law?

24 Mr. Chapoton. It was a sunset provision, and it just
25 wasn't renewed.

1 Senator Heinz. Like the R&D tax credits expiring next
2 year.

3 Mr. Chapoton. And then, finally, we agreed that any
4 increase in the 15-year write-off period for real estate
5 generally would not be applicable to low-income housing. So
6 it would stay at 15 years.

7 Senator Heinz. If we change to 20.

8 Senator Bradley. So, those were the three changes
9 that Treasury agreed to?

10 Mr. Chapoton. Yes, sir.

11 Senator Bradley. Do we have any sense of how many
12 projects will be affected by this? I mean, how many
13 projects are now in receivership nationwide?

14 Senator Heinz. The best information I have is that,
15 in terms of projects in receivership, there are 236.

16 Senator Bradley. Is there any data that you could
17 point to that would show that indeed these wouldn't be
18 purchased by someone unless you provided these generous
19 benefits?

20 Senator Heinz. The data is in the possession of HUD.
21 I am going on HUD's representations to us.

22 The Chairman. All right. Let's start on page 6, at the
23 top of the page there, "Repeal the Tax Exemption for the
24 Federal Home Loan Mortgage Corporation." That's the last
25 page.

1 Dave, do you want to address that? That is not only
2 a recommendation from the Grace Commission, it is another.
3 I don't know whether the Joint Committee or somebody else
4 made that recommendation.

5 Mr. Brockway. Mr. Chairman, right now the Federal
6 Home Loan Mortgage Corporation operates similar to Fannie
7 Mae, but while Fannie Mae is subject to tax, the Federal
8 Home Loan Mortgage Corporation is statutorially exempt, and
9 I guess it performs just a function of buying and marketing
10 mortgages and conducting it as a business, as it is
11 basically owned indirectly by the savings and loan
12 industry. This would simply just tax it as any other
13 corporation, but it would grandfather all previous profit
14 in prior years, and just future income would be subject to
15 tax. And that would pick up .2 billion over the period.

16 The Chairman. Any objection?

17 Mr. Brockway. As far as I know, it is not a terribly
18 controversial proposal. At one point and maybe even right
19 now, they have even acknowledged that it would be preferable
20 for them to be subject tax, because they want to privatize
21 totally.

22 The Chairman. All right. What about electronic
23 transfers of alcohol and tobacco taxes?

24 Mr. Brockway. There are two items in this proposal.
25 Right now, various excise taxes, and particularly the

1 alcohol and tobacco taxes are collected the first 15 days
2 of the month. The taxes for that period have to be paid
3 to the Government anywhere between 15 days and 30 days after
4 that period. In the same way, the second 15 days in the
5 month they have to be paid with a couple of weeks to a month
6 lag to the Government.

7 The Grace Commission has recommended, first, that there
8 be electronic transfer of those taxes; and, second, that
9 the transfer occur at the close of the period, so that the
10 taxes for the first 15 days of the month would be paid on the
11 15th, and the taxes in the remainder of the month would be
12 paid on the last day of the month.

13 This is basically a timing issue of just accelerating
14 the payment for that two-week period.

15 The Chairman. All right.

16 There has been some question raised to the second
17 portion of that. Here it is, a letter from Senator Tribble.
18 It says, "It would require the cigarette manufacturers to
19 clear their accounts with the warehouses every seven days and
20 pay the taxes three days thereafter. This would cause a
21 hardship. It would require the industry to stay on an
22 average daily cash deficit of \$400 million."

23 Mr. Brockway. Well, Mr. Chairman, there is no question
24 that any time you speed up the payment of someone that that,
25 compared to where it is in present law, would do somewhat

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1 worse in the fact. This is an item on which there was an
2 appropriations rider at one point, that I believe is still
3 in effect.

4 But where you get your revenue in this item is by the
5 swing from really on September 30th, that period,
6 accelerating it to earlier in the fiscal year, the tax
7 collections for the last 15 days of that month. So this
8 is basically putting them on a current-payment basis. They
9 have already sold the product. They may not have collected
10 their revenue from the customer, but they have made their
11 sale, and this just means that at the close of that period
12 they should get the money to the Government currently,
13 without any float.

14 By the way, I guess I didn't point this out, this
15 picks up, in a one-time pickup, \$500 million.

16 The Chairman. I assume there are variations of that,
17 aren't there? Where you could reduce the pain?

18 Mr. Brockway. We certainly could work with that, but
19 it will be important to make sure that you do get the
20 acceleration to earlier fiscal year. But we could look at
21 variations, perhaps for earlier periods. We have done this
22 in other areas, but at least for that last fiscal period of
23 the year, the September-30 period, and make sure it is
24 current, and then other ones, give them a week lag, if that
25 is what they were talking about.

1 Senator Bradley. Mr. Chairman, why does it lose
2 revenue in 1986?

3 Mr. Brockway. Because the tobacco tax is scheduled to
4 go down. So, when you have accelerated all the tax payments
5 up, you have accelerated, also, tobacco payments earlier.
6 And since the tobacco tax is going to decrease from 16 cents
7 to 8 cents, I guess, at the end of 1985, that is just the
8 swing on that.

9 Senator Bradley. If it stayed at 16, what would it
10 mean, then?

11 Mr. Brockway. I think your number stays at .6. I'm
12 not sure.

13 The Chairman. All right. What is that next item, the
14 "Tax Benefit Rule"?

15 Mr. Brockway. That is an item that I think is
16 generally agreed to be just a mechanical error in present
17 law, at least in the regs. The tax benefit provides that if
18 you have a deduction in one year and you recover that item
19 in a later year, you ought to take that item into income,
20 so you are in the same position as if you never had occurred
21 the expense, because you have been made whole.

22 There is a problem the way that works, with the zero
23 bracket amount and then operating loss rules. In the
24 regulations, particularly in the case of State taxes, that
25 if you have a refund of previously deducted taxes and you have

1 gotten a tax benefit in year-one, the first year, and you
2 get the overpayment refunded in the next year, to the extent
3 you did get a tax benefit in year-one, a deduction, you
4 ought to have it included in income.

5 But the way the regs work is that sometimes you may
6 have gotten a tax benefit and you aren't required to take
7 it into income.

8 I will try to illustrate this with an example of a
9 situation of a taxpayer who had, other than his State
10 taxes, had \$3200 of deductions. He had \$500 of State tax.
11 That gives him total itemized deductions of \$3700. His
12 zero bracket amount, assuming he was married, was \$3400,
13 so his net itemized deduction that he could claim on his
14 tax return was \$300. He got that tax benefit.

15 So, if he had a refund the next year, up to \$300, and
16 since it was a deduction in Year one, he ought to include
17 that in income. So he would net out the same.

18 The way the regs work, however, is that they order it
19 backwards. So, since \$200 of that \$500 you didn't get a
20 tax benefit for, because that was under the ZBA, they say
21 that that was the first amount refunded, so that the first
22 \$200 of the refund he doesn't have to include in income.

23 And in that case you are better off if you had that
24 \$200 deduction in Year one refunded in Year two than not
25 having paid the tax at all. That picks up \$800 million, and

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1 as far as I know, there is no controversy over that. I don't
2 think there is any argument that the right rule is to have
3 this change.

4 The Chairman. Without objection, then, we will
5 tentatively agree to that.

6 Let's move on to the 20-year cost recovery for used
7 property.

8 Senator Packwood. Mr. Chairman, Senators Chafee and
9 Heinz just left for the Energy Committee. They will be
10 back. They said they wanted to comment on this and asked if
11 we could pass over it for the moment.

12 The Chairman. I know Senator Pryor wants to comment,
13 too, and I think Senator Bentsen may have a substitute.

14 Senator Packwood. And I want to comment, too.

15 Senator Pryor. I would like to comment, but I will
16 be glad to wait til our colleagues return.

17 The Chairman. We had better wait until they return,
18 then.

19 Now, next is the Telephone Excise Tax.

20 Mr. Chapoton. Mr. Chairman, at some point, though,
21 Senator Durenberger was the one principally concerned about
22 the charitable rule, and I think Senator Danforth.

23 We have discussed with staff an alternative that I
24 think we could live with and that I think is agreeable. I
25 am not sure whether Senator Danforth's staff has signed off

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1 on this or not, but Senator Durenberger's staff has.

2 Would you like me to go through it and describe that
3 now?

4 The Chairman. Right.

5 Mr. Chapoton. This, as you remember in the proposal
6 dealing with the gemstone type problem in our package, was
7 a three-year proposal; that is, a charitable deduction for
8 appreciated property would be limited to the cost basis in
9 the property if the donation were made within three years
10 after the property was acquired.

11 There was some concern that that would have a chilling
12 effect on gifts of appreciated property during the three-
13 year period. We tried to run as much data as we could, and
14 our data showed that it would affect only 6 percent of total
15 giving during that period, during the three-year period.

16 Senator Packwood. Buck, I'm curious. Do you presume
17 it affects it? Or would it simply delay the giving?

18 Mr. Chapoton. Well, it affects it. Now, what effect
19 it has -- in other words, the proposal would affect only
20 6 percent of value given during that period.

21 Senator Packwood. In other words, you are saying that
22 only 6 percent of the gifts are made during that period,
23 anyway?

24 Mr. Chapoton. No. I am saying only 6 percent of gifts
25 made during that period would have appreciation that would be

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1 affected.

2 Our thinking is that that would have a very small impact,
3 and I think you are right, to the extent that it had any
4 impact at all, the impact would be a deferral, not a change.

5 But we do agree that the problem we are dealing with
6 is a valuation problem, the acquisition of property and then
7 immediately turning around and giving the property away,
8 claiming a large increase in valuation.

9 So, others have attempted to fashion a rule that would
10 be much tougher on valuation. Let me just go over the
11 rules they have proposed. Our thinking is, if the committee
12 sees fit, we could accept this alternative. There are a
13 couple of open points, still.

14 The first is an exception. This would not apply,
15 these rules I will describe would not apply, to any one
16 gift up to \$2000. That would just be dropped out, unless
17 the total gifts under the \$2000 exceeded \$5000; so that if
18 you make --

19 Senator Packwood. Wait a minute; you lost me there.

20 Mr. Chapoton. If the total gifts under \$2000, when you
21 total them up during the year if they exceed \$5000.

22 Senator Packwood. Oh, I understand. There is a single
23 per-\$2000 gift, and a maximum of \$5000 a year? Is that what
24 you are saying?

25 Mr. Chapoton. Correct.

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1 Senator Packwood. All right.

2 Mr. Chapoton. The first substantive rule is that the
3 donor must obtain a qualified appraisal from a person who
4 does not receive a percentage fee, a fee based on the
5 percentage of the value, and the appraiser must not be
6 related in any way to the transaction.

7 The second rule is, the appraisal must be signed by
8 the appraiser, so he would be liable for aiding and abetting
9 a substantial understatement, if the substantial
10 understatement penalty should apply.

11 The appraisal would have to set out his qualifications,
12 and the basis for his valuation, and Treasury would be given
13 the authority to designate a form, an IRS-type form, that
14 would have to be attached to the return and signed by the
15 appraiser.

16 Senator Packwood. Buck, I am curious. What does IRS
17 do now?

18 Mr. Chapoton. I was going to tell you. That adds very
19 little to existing law, except requiring the signature of
20 the appraiser.

21 Senator Packwood. Because I assume if somebody says
22 "This picture is worth \$200,000," and you say "100,000," the
23 donor has got to justify the \$200,000, and they have to
24 name somebody as appraising it.

25 Mr. Chapoton. That is correct. And actually the

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1 regulations now say they should submit a copy of the
2 appraisal. I don't think they do it, but we think there
3 is some benefit for having the appraiser actually sign
4 something that is going to be attached to the return.

5 The next thing would be, if the donee organization
6 disposes of the property within two years from the date
7 of the contribution, the donee must furnish to the IRS the
8 donor's name and taxpayer I.D. number and the amount
9 received on the sale.

10 The next one would be a new over-valuation penalty,
11 that if the property donated were valued by the donor at
12 150 percent or more of the property's actual value, then
13 the penalty for over-valuation would be all tax benefits on
14 the contribution would be lost, so he would get a zero
15 tax deduction. This would apply to estate and gift tax
16 deductions as well as income tax deductions.

17 In other words, an attempt to over-value could be
18 quite costly to the donor.

19 And finally, and this is the rule that we frankly have
20 to look at a bit more, but if it is possible we would like
21 a rule that when a valuation case goes to court, that the
22 court is required to accept one of two values, either the
23 taxpayer's value or the IRS's value, but cannot compromise
24 in between; because we now have the case where the taxpayer
25 has an incentive to go in with a very high value, knowing that

1 he will compromise somewhere in between.

2 We think if you can have such a rule in the courthouse,
3 that would cause taxpayers to come in with a more
4 reasonable value at the outset. But we need to look at that
5 rule a bit more.

6 The Chairman. We are losing money on this deal, right?

7 Mr. Chapoton. Mr. Chairman, we don't know what the
8 value is. We think it will not pick up the amount of money
9 that the three-year rule would; but the amount of money that
10 the three-year rule picks up was quite small, too.

11 Senator Long. Why don't I just comment on that.

12 I swear I can't see the logic of saying that the court
13 can't fix the valuations. This is a gift we are talking
14 about, I guess, a deductible gift.

15 Some fellow comes in and says, "Well, this is worth
16 \$3000," or pick a figure, and the Treasury says, "No, it's
17 only worth \$1000." Why on earth can't the court split the
18 difference and say, "Well, after considering, I'm convinced
19 that the Treasury is on the low side, and this other guy is
20 on the high side, so we will fix it at \$1500"?

21 To try to say by law that the court can't fix it at
22 what the court thinks it is worth seems to me patently
23 ridiculous. How do you justify that?

24 Mr. Chapoton. Senator, the whole point of these rules
25 would be to give a very hard incentive, a very definite

1 incentive, for taxpayers to pick a value more in line with
2 true value. And that would have that impact, we think,
3 because if the taxpayer overreaches on valuation, then he
4 would know that he cannot fall back on, "Well, the court is
5 going to reduce it back some, but not reduce it too
6 dramatically." And he knows he can go and compromise. So
7 there is really no down side now, and this would create more
8 of a down side problem.

9 Senator Long. But to me, it just conflicts with
10 everything that seems to make any sense or justice.
11 to say that that court can't fix the valuation at whatever
12 the judge thinks it is worth. And for us to say by law he
13 can't makes me ask why do we have courts to begin with?
14 Why shouldn't the judge fix it as what he thinks it is?

15 Mr. Chapoton. The whole reason is to attach a greater
16 penalty for overvaluation by the taxpayer and undervaluation
17 by the IRS.

18 In a perfect world, certainly we would have the court
19 fix the actual value. In a perfect world, we would have the
20 taxpayer pick the actual value at the outset.

21 Senator Long. And then you want to say that if the
22 taxpayer values it for his tax purposes, if he values this
23 thing at more than 150 percent of the value, he gets no
24 deduction at all. Is that correct?

25 Mr. Chapoton. That would be the proposal.

1 Well, suppose he did it honestly and in good faith?
2 Suppose he gets an appraiser, and the appraiser goes out
3 and looks it all over and says, "Well, it's worth \$1500,"
4 and you can convince the judge it wasn't worth but \$900;
5 he gets no deduction at all? I mean, it seems to me -- even
6 though he is in good faith, and he had a reputable person
7 advising him?

8 Mr. Chapoton. That is correct, Senator. The problem is
9 that we now know that appraisals are simply not reliable,
10 frankly. These rules, to have any meaning at all, have to
11 have an effect that might well be described as an
12 interaurum effect, to make people want to arrive at a
13 closer to true value at the outset.

14 Now there is no incentive for a taxpayer to really want
15 a true value. He can always compromise the value out at the
16 court, come down closer to something of true value. And we
17 see a lot of problems with appraisals in the tax law in
18 charitable giving.

19 Senator Long. Well, if you will pardon me for saying it,
20 Mr. Chapoton, it just looks to me like (a) we ought to audit
21 just a great deal more returns that we audit. Par for the
22 course is, most of these things slide on by without being
23 audited at all, don't they?

24 Mr. Chapoton. That is correct.

25 Senator Long. All right. So we ought to audit just a

1 great deal more than we audit. I have been trying to get
2 you to hire some people on a contingency basis, just let
3 them work for the taxpayer one day and work for you the
4 other day, work both sides of the fence.

5 But audit these things, so that when people claim
6 something that is probably wrong, that is just par for
7 the course that they will be audited. And the chances are
8 pretty good that you will catch it and they'll have to pay
9 something.

10 But to come in here with these arbitrary rules, when a
11 person in good faith is claiming that what he is giving is
12 worth 155 percent of what you think it's worth -- mind you,
13 you are putting your value judgment on it. He has somebody
14 advising him, and they claim 155 percent -- well, the value
15 is speculative. It is a matter where one person has one
16 opinion and somebody else has a different opinion. And
17 then to say that he gets no deduction at all because he
18 claims 155 percent of what you think the value is, to me
19 that is just the height of arbitrariness.

20 Mr. Chapoton. Senator, I agree. It certainly is
21 arbitrary. And certainly if we could increase audit
22 activity on these types of returns, that would be desirable.
23 But we have to recognize audit activity is below 2 percent
24 now. Let's say you moved it up to 3 percent; there would be
25 a dramatic increase in audit activity. But our system cannot

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1 rely on audit activity to catch problems. Our system is
2 a self-assessment system. It has to have provisions in it
3 to encourage taxpayers to file correctly, and if they
4 don't the system breaks down.

5 Senator Long. I am not sold on it. I would hate to
6 think that we are in such bad shape in our country in
7 collecting our money that we have got to be arbitrary and
8 unfair.

9 At some point we may just have to raise taxes, or come
10 up with a new tax, such as the energy tax or goodness knows
11 what. But to say we are in such bad shape that we have to
12 be unfair to the taxpayer and arbitrary, no wonder people
13 get down on us.

14 I know it is supposed to be somewhat of a joke that
15 any time the collector of Internal Revenue walks up before
16 a crowd, they all automatically boo.

17 (Laughter)

18 Senator Long. But I would hate to think that they are
19 damned well justified in booing the man.

20 (Laughter)

21 Mr. Chapoton. Well, Senator, I think our first choice
22 would still be to go back to the three-year rule we
23 originally proposed. But I will state we could live with
24 this rule.

25 As I stated, I recognize there are arbitrary aspects

1 to it; but I have to say, when you look at the valuation
2 problems we now see, we don't see an answer to it.

3 The Chairman. All right. Without objection, or without
4 further objection, the compromise, I guess, will be agreed
5 to.

6 I wonder now if we might move to the recommendation of
7 the Grace Commission on the spending side?

8 Senator Symms. Mr. Chairman, before we go could I just
9 bring up one more small point on the tax side? Thank you,
10 Mr. Chairman.

11 The question I wanted to direct to Buck relates somewhat
12 to the question Senator Boren and others were talking about
13 here earlier, about prepayment. But you have a proposal in
14 here for "premature accruals," and it says here, "An
15 accrual deduction would not be allowed until economic
16 performance has occurred."

17 Mr. Chapoton. Correct.

18 Senator Symms. All right. What happens if someone
19 ends up that they perform more? Are you going to pay them
20 interest on the money? Or is this just a one-way street?

21 Mr. Chapoton. Well, the deduction is allowed when
22 economic performance occurs.

23 Senator Symmes. But what I am talking about is, you
24 take a guy out here who is working. Let's say he has a job
25 for \$100,000 a year and he is having his income withheld --

1 or \$50,000 a year. Then he gets fired on the Fourth of
2 July. And he doesn't have a job for the next six months.
3 But the Government has withheld his money. He won't get
4 his money back until next April 15th or later, with no
5 interest.

6 But if I understand this correctly, you are going to
7 charge people for the use of their money.

8 Mr. Chapoton. No, we are not charging people for the
9 use of their money. That is simply a disallowance of
10 deduction.

11 The problem you are addressing, Senator, is an
12 overwithholding problem, and overwithholding is always a
13 problem in a withholding system.

14 Senator Symms. What are you talking about doing on
15 premature accrual?

16 Mr. Chapoton. On the premature accruals, we are simply
17 saying that a taxpayer in almost all cases, and I believe
18 in every case, would be a business taxpayer that claims a
19 deduction for expenses that will not be incurred, and
20 economic performance which will not take place until years
21 later, it would not be deductible until economic performance
22 occurred.

23 Senator Symms. What if it costs them more than they --

24 Mr. Chapoton. That is the beauty of this rule. The
25 deduction is taken when the performance occurs. We are saying

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1 that the tax law should not allow an accrual-basis taxpayer
2 to take that deduction currently.

3 Senator Symms. But you are taxing them for the value
4 of their money, then. I mean, you are going to make the
5 taxpayer pay taxes on the same principle, as I see it, as
6 the person who goes out and prepays his drilling costs or
7 prepays his cattle fee. He gets it, probably, for a lower
8 amount of money because he prepaid it, and the cash in hand
9 is worth something. So the deduction is smaller, so you get
10 less money back to Treasury in that respect. But that
11 person prepaid the bill.

12 Now, on the other side of it, you are going to make that
13 taxpayer pay interest on that money.

14 Mr. Chapoton. Senator, he will not have paid an
15 expense. There will be no disallowal of a paid expense here,
16 see. This is where, without this rule the claim is that an
17 accrual-basis taxpayer should be allowed a deduction for an
18 expense of let's say a million dollars that he estimates will
19 be incurred five years hence.

20 We are saying that if economic performance will occur
21 five years hence, he ought to take the deduction then and not
22 now.

23 Senator Symms. All right.

24 What about an accrual situation where say you rent a
25 building or lease it to somebody for so much a year, and you

1 are making this person pay their taxes on the accrual basis.
2 And then, along in the middle of the process somebody goes
3 bankrupt or abandons a contract, or whatever, for whatever
4 reason, so they don't get the anticipated revenue. You are
5 not going to pay them interest back on that money, then.

6 Mr. Chapoton. You don't pick up rental income -- rental
7 income is now on a perfect accrual rule such as we are
8 proposing here; that is, it is allocated to the period of
9 the lease. You can't have prepayment of rent, and you don't
10 pick up rent in advance.

11 Senator Symms. Yes, but what if the guy has paid taxes
12 on it, and then --

13 Mr. Chapoton. But he will not have paid taxes in
14 advance under our rent rules.

15 The concern, Senator, and let me be completely candid,
16 the concern of a rule such as a premature accrual rule is
17 whether the future expense should be related to the income
18 in this year. I think under proper accounting principles, it
19 is not related to income in this year if the economic
20 performance will occur in a later year.

21 But the argument is made that, even though the expense
22 won't be incurred until later, it ought to be deductible now.

23 Senator Symms. Well then, if that's the case, the
24 Treasury ought to be reimbursing taxpayers who have overpaid
25 their taxes. They ought to be paying them interest.

1 Mr. Chapoton. On the overwithholding?

2 Senator Symms. On any issue.

3 Mr. Chapoton. Well, I'm not sure I disagree with that.
4 I don't think I disagree with that as a general principle.

5 Senator Symms. It looks to me like you have a one-way
6 street here; all roads lead to the U.S. Treasury.

7 Mr. Chapoton. Senator, I think we are ships passing
8 in the night here. I am not sure what we are talking about.

9 The Chairman. We have all the principals here now who
10 wanted to be heard on the 20-year cost recovery for new and
11 used structures. Senator Bentsen, I think, wanted to suggest
12 there may be an alternative.

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

14 I have a very serious concern about the proposal that
15 would be applied to all used structures, commercial and
16 residential.

17 I think there have been abuses. I think the abuses
18 have principally been on the commercial side. When we had
19 this proposal before us a couple of years ago, at that time
20 I suggested that we were probably being too generous on
21 commercial structures. And I think that has proven to be
22 the case.

23 We have a situation now in Houston where they are
24 building 30 and 40 and 50 story buildings, some of them
25 virtually without tenants. They are not really economic

1 objectives; they are tax objectives. And that's the way it
2 is being done.

3 The problem, though, if you do that to housing, you
4 end up raising rents, and I think that's a mistake. We took
5 care of low-income housing, but how about middle-income
6 housing? How about families where they have to go to two
7 paychecks, even though the wife has some kids at home and
8 wants to stay them, but there is no other way they can make
9 it, they can cut it. Well, one of the problems is what they
10 have to pay out for housing, what they have to pay out in
11 rent.

12 So, I would like to see housing totally excluded, new
13 and old. But then I would like to see us go ahead and go
14 to the 20 years on commercial, new and old.

15 I know there will be some resistance to that, but I
16 think Jack Danforth is right, when we say that we want a cut
17 on one side, we ought to try to raise the money somewhere
18 else. We ought to have the political courage to do that.

19 Now, the estimates I have say if we take this kind of
20 action, instead of raising 1.4 billion we will raise 3.5
21 billion; there will be over \$2 billion in additional revenue
22 that will come in. And I think we will target in on an area
23 where there has been some abuse.

24 By the same token, I think we will continue to keep
25 housing costs as low as we can. And I would very much

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1 recommend we make that kind of a change.

2 Now, again, Mr. Chairman, that will not be without
3 controversy, and there will be people obviously who will
4 strongly disagree with me on that; but I think we hired out
5 to take those kinds of criticisms, and I think this is a
6 worthwhile objective.

7 The Chairman. Thank you.

8 Senator Pryor?

9 Senator Pryor. Mr. Chairman, I don't want to speak
10 against the concept that Senator Bentsen is raising at this
11 point, but if I might I would like to raise two or three
12 questions.--

13 The Chairman. Sure.

14 Senator Pryor. -- with regard to the proposed change,
15 which is a departure, of course, from the procedure or the
16 system that we adopted in 1981.

17 The first question: Is the proposed change that we are
18 talking about here in the 20-year from the 15-year, the
19 proposal, is this in the 1985 budget?

20 Mr. Chapoton. No, sir. No, there is nothing in the
21 budget on this.

22 Senator Pryor. Is the change supported by the
23 Administration?

24 Mr. Chapoton. We can support the used property change
25 suggested by the staff, and we would like to look more at

1 Senator Bentsen's proposal. Our concern has been, in the
2 real estate area, what we call the "churning problem," that
3 is, that the depreciation for used property is generous
4 enough and the recapture rules are lax enough that we are
5 seeing some churning of property. And that has been our
6 primary concern.

7 Senator Bentsen's proposal will certainly address that
8 and more, but not address it in the housing area. So, we
9 would like to look at that.

10 Senator Pryor. Do we have any figures available as to
11 the impact of changing this from 15 to 20 years, either
12 new or used? Do we have figures or any sort of a computer
13 printout with regard to what a change does, as to the
14 impact it has not only on rehabilitation of those structures
15 but the construction of new structures?

16 Senator Bentsen. Well, let me say that I am speaking
17 of just commercial as far as going to the 20 years,
18 Senator Pryor. I am not speaking of housing at all. I want
19 to see that we do all we can to try to keep the cost of
20 housing down.

21 Mr. Brockway. Senator Bentsen, if I may clarify
22 something, you are talking about all real estate other than
23 residential? So, in other words, commercial and industrial,
24 a combination, going to 20 years, as I understand it.

25 The Chairman. Senator Packwood?

1 Senator Packwood. Mr. Chairman, I don't know if others
2 have had the experience I have, but in traveling around this
3 country I have run across developer after developer who has
4 taken great pride in selling tax shelters and rehabilitating
5 alleged historic buildings, where a deal has been made with
6 the local zoning commissioner or whoever makes the
7 designation to call a building that is marginally historic
8 "historic." Having gotten that designation, they then take
9 advantage of tax shelters to build the equivalent of a very
10 modern interior shopping mall, leaving the facade of the
11 building up. You know, "the facade is pretty." But the
12 purpose is tax shelters.

13 I am with Lloyd totally on this. I think we ought to
14 go the route he is suggesting.

15 The Chairman. Senator Roth?

16 Senator Grassley. We are talking about just doing it
17 in the future, right?

18 The Chairman. Right.

19 Senator Grassley. For those buildings that have been
20 built and everything, they would still have their
21 depreciation?

22 Mr. Brockway. Senator Grassley, our numbers are
23 promised. For used property, it would be after the date of
24 committee action. For new, it would be commencing next year.
25 The reason you would have the used right now is so you

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1 wouldn't have churning of the property before the effective
2 date.

3 Senator Grassley. It would be as of a date right about
4 now?

5 Mr. Brockway. Right, for used property, so that that
6 wouldn't turn over. But for new, you would start later.

7 Senator Symms. Could one of you explain why 15 years
8 versus 20 years would make any difference in churning?

9 Mr. Chapoton. Yes.

10 Senator Symms. How does that address that question?

11 Mr. Chapoton. If you put a longer life on used property,
12 it -- what we now have is the case where after a point, you
13 can calculate it just over a period of years, but after
14 Year 8 or 9, the property has more benefits in the hands of
15 a purchaser than it does the original owner. So you will
16 clearly see. And you calculate in that the recapture to the
17 original owner, if he sells it, and the new tax benefit to
18 the purchaser if he buys it. So if a purchaser can buy it
19 and write it off over 15 years, and the seller does not have
20 it, this purchaser gets a stepped-up new basis and a new
21 write-off. If the seller doesn't have recapture as ordinary
22 income, then it simply is going to happen.

23 You reduce the purchaser's benefits from buying used
24 property if you take the used property from 15 to 20 years.
25 So in running that calculation, it will simply be less

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1 beneficial for the purchaser to buy it as used property.

2 Senator Symms. But it is true, though, that the shelter
3 is still there for the long term.

4 Mr. Chapoton. Yes.

5 Senator Roth. Mr. Chairman, I have just one suggestion.
6 I have an open mind on what Lloyd Bentsen had just proposed,
7 but I wonder if it wouldn't be desirable on this and a few
8 other matters where we haven't had hearings to try to quickly
9 schedule some hearings.

10 I am a little concerned. Just to take another example
11 involving the credit unions. Before we move, I think it
12 would be worthwhile if we could have some quick hearings to
13 determine the impact.

14 Now, as I understand, the Treasury is saying they are
15 not able to advise us today until they are able to study it
16 further.

17 Mr. Chapoton. No, sir, we are not.

18 Senator Roth. But I will be candid; having gone ahead
19 once on the trucking legislation and then finding that we
20 had moved in a way that was very damaging to small truckers,
21 I wonder if we couldn't agree on some of these proposals
22 where there haven't been hearings to schedule such? Would
23 you object to that, Senator Bentsen?

24 Senator Bentsen. Well, I would say on the one -- I
25 don't want to get into the other issue at this point -- I

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1 would like to stay with the real estate issue.

2 Of course, we had some hearings on this.

3 Let me give you an example of some of the kinds of
4 abuses. I don't know how many of you read the Forbes
5 article. It was talking about the Boca Raton Hotel in
6 Florida, which early in 1983 couldn't be sold for
7 \$100 million, but then was sold through a syndication late
8 last year for \$150 million. And of course it gave huge
9 tax write-offs to the investor, and at the same time huge
10 profits to the syndicator.

11 I look at a situation now in Houston where they are
12 building buildings really without tenants, some of them, and
13 then turning around and instead of \$30 a square foot going
14 ahead and doing it at \$10, to move people into them, and
15 still having themselves a profit taxwise. I think that they
16 are being motivated by the tax considerations rather than by
17 the economic considerations. And whenever you do that, the
18 tax law isn't working properly.

19 So I think we ought to face up to that kind of thing
20 and try to correct it.

21 See, we went from 30 and 40 years on those builsings,
22 as I recall from hearings before, down to 15. I seriously
23 questioned at that time doing that on commercial buildings.
24 As I recall, I was the only one who offered an amendment, for
25 example, at that time on safe harbor leasing. I said, "I'm

1 a fellow who believes in incentives for investment; but I
2 think you can go too far in it."

3 I remember the next year we had 21 amendments to do
4 away with safe harbor leasing. So I am trying to ring the
5 bell on one here, where I think that we went too far.

6 The Chairman. Could I just ask Rod to recite the
7 Metromedia example that gets into that same area?

8 Mr. DeArment. Jim knows a lot about it, but it was
9 basically the largest syndicated tax shelter in the history
10 of the United States.

11 The Chairman. Tell us what happened, Jim.

12 Senator Bradley. This is the billboards?

13 Mr. DeArment. Yes.

14 Mr. Wetzler. Metromedia owned 45,000 billboards, which
15 it sold to a limited partnership organized by a major
16 investment banking house for \$480 million, approximately.
17 As Rod points out, it was the largest tax shelter in history.

18 Billboards are treated under the law as real estate
19 and would get a 15-year write-off. And this proposal would
20 increase that to 20 years. So it would slow down the benefits
21 by a modest amount.

22 Senator Bradley. But, don't billboards help our
23 economic recovery and competitiveness?

24 (Laughter)

25 Mr. Wetzler. These billboards were already there, it's

1 just that they were old billboards.

2 Senator Heinz. Mr. Chairman?

3 Senator Grassley. Mr. Chairman?

4 The Chairman. Senator Heinz, and then Senator Grassley.

5 Senator Heinz. Mr. Chairman, just a few questions. But
6 first let me say there are some things in Senator Bentsen's
7 amendment that strike me as an improvement on what was before
8 us. But is is a major amendment. It will, as he says,
9 raise almost twice as much money, \$3.1 billion, which is
10 nearly a third of what we are shooting to raise. So it is
11 very substantial.

12 The Chairman. Well, we still need about 20-some.

13 Senator Heinz. It is not a question of what we need;
14 we need more than that, probably, Mr. Chairman. But as I
15 understand what we are shooting to raise in this book, it is
16 a substantial piece, as I understand the book.

17 In any event, I have a couple of questions I would like
18 to address to the Treasury Department here. Number one, if
19 we want to address the churning problem, and clearly there is
20 some churning going on, is there more churning going on in
21 residential and commercial syndications than there is in
22 residential? Or is there a proportionately equal amount of
23 churning going on in both areas?

24 Mr. Chapoton. Senator, I can look back at the data that
25 we have and try to determine it. But I would expect it is

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1 roughly the same. I don't know, though.

2 Senator Heinz. It is roughly the same.

3 Now, secondly, in terms of the life of structures --

4 Mr. Chapoton. The economic life?

5 Senator Heinz. -- the economic life of structures,
6 current law assumes that there is, rightly or wrongly, that
7 there is parity in the life of commercial and industrial
8 structures, on the one hand, with residential structures on
9 the other, and therefore they are now treated alike. In
10 terms of economic life, is there much significant difference
11 between residential structures as opposed to commercial and
12 industrial?

13 My experience is, and maybe it's because I live in a
14 180-year-old house and not in a 180-year-old warehouse,
15 that residential structures tend to persevere a lot longer
16 than commercial and industrial structures.

17 Senator Bradley. Isn't the short answer to that
18 question that both are a lot longer than 15 years?

19 Senator Heinz. That is certainly one of the answers,
20 but it is not the only answer.

21 Mr. Chapoton. I think you have got to look at the type
22 of structure. When we used to have guideline lives, it
23 depended on what the structure was made of, what industry it
24 was being used in. So I think you can't answer that question
25 across the board.

1 Senator Heinz. Well, the reason I am curious is, if
2 it is bad for us to do something with commercial and
3 industrial regarding 15 years, and if syndications and
4 churning is bad in commercial, and there is no particular
5 evidence that apparently anyone can cite that commercial
6 and industrial structures have a longer life than
7 residential structures, and a lot of anecdotal evidence to
8 the contrary, it would seem to me we ought to treat them
9 both the same.

10 Senator Bentsen. Well, Senator, I think on that you
11 have the question of social objectives, and I am much more
12 concerned about rental for housing than I am as far as
13 someone having to pay \$25 instead of \$20 for office rent.

14 Senator Heinz. I understand the Senator's concern, but
15 we have taken care of low-income housing. We have an
16 agreement on that.

17 Senator Bentsen. I am interested in that moderate
18 income, in addition.

19 Senator Heinz. And my understanding is that most
20 Americans don't rent. Most middle-income Americans
21 actually are homeowners. We have by prior agreement here
22 protected the low-income people, and I just want to be sure,
23 Lloyd, that we are not unnecessarily protecting some
24 syndications. I don't disagree with what you are saying, but
25 as I understand the way things would work if we agreed to

1 your amendment, that the kinds of apartments we are talking
2 about are middle and upper income apartments. Low income
3 people are going to be protected in any event; we all agree
4 on that.

5 The question is, how important an element is that? Is
6 it worth making a special exception for middle, upper-middle,
7 and luxury apartments? And, if it is a tax abuse, why don't
8 we deal with it?

9 Now, what you are saying, as I understand it, is that
10 people's rents will be raised. My understanding would be
11 they would only be raised if the building they were living
12 in was resyndicated. They would not be raised if the
13 building was not resyndicated, at least as I understand the
14 way real estate works. Is that not correct?

15 Senator Bentsen. No. I think you would have a
16 situation, not just that; I think you would have fewer of
17 them built, in addition, if you go to 20 years. And I think
18 that also brings up the rents. And I am talking about all
19 housing, whether someone has a second house they rent out
20 and that that is a rental income for them, or whether they
21 have a duplex, or whatever.

22 Senator Heinz. I think that is probably true. I
23 would certainly concede that point. You would have fewer
24 built.

25 Senator Bradley. Would the Senator yield?

1 Senator Heinz. Yes.

2 Senator Bradley. Is the point you are trying to make
3 that what this amounts to, once you have kind of exempted
4 middle-income housing, is a subsidy to middle-income
5 housing? And we already have sizeable other subsidies. The
6 question is, we also have an industrial base. Right? And
7 you are worried that your factories in Pennsylvania are not
8 going to get the same kind of treatment as residential
9 housing for upper-middle income people who already have
10 sizeable subsidies anyway for housing. And I think it is
11 a legitimate concern.

12 Senator Heinz. The Senator is correct, but it's not
13 my only discomfort. There is the differential, that we are
14 going to, in a sense, give a better deal for certain kinds
15 of housing for people who certainly are not poor than we are
16 going to give for commercial and industrial development, and
17 the jobs they create. And that troubles me in and of itself,
18 that we are making a very conscious choice for one sector
19 of the economy here that may -- I can't say for sure, but
20 may -- operate to the detriment of at least an equally if not
21 more important sector.

22 Secondly, it seems that if the issue that one is a tax
23 shelter, and that it is abusive, and that we ought to change,
24 that both, since they are both used for the same purposes,
25 are tax shelters that are abusive and ought to be changed.

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1 To be intellectually honest about it, I just don't see
2 how you can say one is good for the goose, but the gander
3 should go home and lay golden eggs.

4 Senator Bentsen. Well, I think I have stated from the
5 beginning that there is no question but that there are
6 abuses on both sides. And I said that in the very
7 beginning. But I said I think housing is quite a different
8 thing from an office building and what is paid there.

9 While you say it is not for the poor, well, some of them
10 think they are poor, and some of them are awfully close to
11 being poor and don't qualify for so-called "low-income
12 housing." I know a lot of young couples who are getting
13 started that wouldn't qualify for low-income housing but
14 who are having a very tough time of it. And it is terribly
15 important to them what that rent is. And you are not talking
16 about just a few folks; you are talking about massive numbers
17 of people.

18 Senator Heinz. Senator Bentsen, I don't wish to argue
19 the point that there aren't people who aren't deserving and
20 who would benefit from your amendment. I think that's true.
21 And I don't wish to argue that point, because I conceded that
22 to you earlier.

23 The question is one of whether we want to differentially
24 aid them in a way that appears to be, on balance, abusive
25 tax policy. If you said, "What I really want is a program

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1 that will aid them in some other way," I would probably say
2 Amen to it. And by the way, I am not sure I am totally
3 against your proposal as yet, but I worry about some of the
4 other effects of it.

5 Senator Bentsen. I am not quite sure what you would
6 say if you were totally against it.

7 (Laughter)

8 Senator Heinz. Well, I always try to keep an open
9 mind as long as I can.

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

12 Senator Danforth. Mr. Chairman, just to review the
13 bidding, it is my understanding that prior to 1981 there was
14 a differential in useful life between residential and
15 nonresidential property. Is that right?

16 Mr. Chapoton. That is correct.

17 Senator Danforth. And there was a differential between
18 old and new?

19 Mr. Brockway. Before 1981 you didn't have specific
20 assigned lives for real estate, and one or the other may,
21 on the facts and circumstances, have been shorter. You did
22 have preferred treatment on the method of depreciation for
23 residential, as right now in current law you have preferred
24 treatment in recapture for residential under ACRS, compared
25 to nonresidential structures. But the useful lives depended

1 on how long the structure lasted. So, if it was an office
2 building, it would be longer than --

3 Senator Danforth. With the Bentsen proposal, this would
4 be the first time that we would have a differential?

5 It would or would not be the first time that we had a
6 differential between residential and nonresidential?

7 Mr. Chapoton. We have always had it, Senator.

8 Mr. Brockway. You have always had it in the method.

9 Senator Danforth. In other words, wouldn't this
10 accentuate whatever differential exists --

11 Mr. Brockway. Clearly.

12 Senator Danforth. -- between residential and
13 nonresidential?

14 Mr. Brockway. I understand that is the purpose.

15 Senator Danforth. And would this also accentuate the
16 difference or reduce the difference between new and old?

17 Mr. Brockway. It would keep new and old the same.
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1 Senator Danforth. What is the economic affect of
2 accentuating the difference between residential and
3 non-residential? There would be, I take it, a difference
4 in economics.

5 Secretary Chapoton. Sure. You clearly would encourage
6 capital to flow in the direction of residential property
7 to some extent, and away from plant and commercial buildings.

8 Senator Danforth. To a greater extent than has ever
9 been done before?

10 Secretary Chapoton. I can't say that, Senator, because
11 traditionally we have provided benefits for housing,
12 residential, over benefits for commercial and residential.

13 Mr. Brockway. It may well have been, Senator Danforth,
14 in the prior law using facts and circumstances that people
15 would have taken for residential property a shorter life
16 than they did for non-residential. So you can't really tell
17 where you are compared to before 1981.

18 Senator Danforth. Then the proposal would be, as I
19 understand it, to accentuate that difference.

20 Senator Bentsen. Let me ask if it isn't just a
21 restoration of the difference in effect. You had a
22 difference before.

23 Mr. Brockway. You had a difference in terms of the
24 method under prior law. There was more rapid depreciation
25 at any given -- like more accelerated.

1 Senator Bentsen. For housing.

2 Mr. Brockway. For housing. And right now you have a
3 preference for housing as compared to non-residential in
4 terms of the recapture on the property even under ACRS. But
5 before that you certainly had a benefit for housing.

6 Senator Danforth. In other words, the Bentsen
7 approach is a policy -- would be a policy determination on
8 our part to skew investment in both old and new real estate
9 toward housing.

10 Mr. Brockway. I think that is clearly correct.

11 Senator Roth. Would the Senator yield?

12 Senator Danforth. Just -- and is there any judgment
13 as to whether that's a good idea or a bad idea or whether
14 that policy differs with respect to purchase of old property
15 and construction of new property?

16 Secretary Chapoton. Senator, that's what we wanted to
17 look at a bit.

18 Senator Roth. And wouldn't this discrimination apply
19 not only to office buildings but to plants?

20 Secretary Chapoton. Correct. I don't know if it's
21 correct to call it discrimination or not, but I think --

22 Senator Roth. Well, difference in treatment.

23 Secretary Chapoton. Senator Bentsen is correct that
24 in pre 1981 and, I think, really throughout the history of
25 the depreciation provisions we tend to give either through

1 shorter lives or a faster method of appreciation a benefit
2 to housing, a bias, if you will, in favor of housing. That
3 bias, I think -- Senator Bentsen is correct -- was reduced
4 under ACRS. This would reinstate it. Whether it reinstates
5 it more than pre-1981 or less, I'm not sure.

6 Senator Danforth. Let me just ask one question. We
7 changed the law in 1981. Is there any guess as to the
8 effect? I mean when we went through that exercise in 1981,
9 we did so with grand fanfare about how this was going to
10 increase investment and we are going to modernize our
11 industrial plant. Did it work? Has it been a good idea?
12 Should we bag it now? Is this the time to adopt a new
13 policy of discouraging investment in plant and encouraging
14 investment in residential? What are we doing?

15 Mr. Wetzler. Senator Danforth, the problem with us
16 being too sure about what happens is since you enacted on
17 depreciation in 1981, you've had a tremendous swing in
18 interest rates in both residential and non-residential
19 structures. They are very sensitive interest rates. And
20 clearly spending on both of these, I'm sure, was higher
21 than it would have been had you not acted in 1981.

22 On the other hand, it went down quite a bit because of
23 the high interest rates in 1981 and 1982, and is beginning
24 to pick up during the last year and this year as a result of
25 the decline in interest rates that occurred.

1 I think the one clear effect with respect to used
2 structures -- and I think everybody agrees on this -- is
3 that there has been a big increase in the churning of
4 used structures. And that, I think, was Senator Dole's
5 intent in proposing a proposal to use both residential
6 and non-residential.

7 Now in certain areas of the country, I think there has
8 been an increase in new structures, both office buildings
9 and apartment buildings, as a result of the ACRS, which
10 reports have it has created some real estate gluts in some
11 sectors of the country.

12 But it's hard to distinguish the effects of interest
13 rates on the one hand versus the effects of ACRS because
14 they worked in opposite directions.

15 Senator Danforth. Well, should we just differentiate
16 between old and new as far as industrial property is
17 concerned?

18 Mr. Wetzler. Considerations in old and new really
19 are somewhat different. In the old structures I think there
20 really is an issue of do you want a system that gives
21 tax incentives to term property, as I think clearly exists
22 today. Moving out to 20 years would reduce, and in many
23 cases eliminate, that incentive. It would create a system
24 that was more neutral.

25 New property, you are really asking the question of how

1 much of a tax incentive do you want for new construction,
2 and to what extent do you want to try to tilt the
3 construction towards either residential or non-residential.
4 And that's really a judgment for the committee to make.

5 Senator Heinz. Would the Senator yield?

6 Senator Danforth. I'm about to yield the floor. I
7 don't know how I'm going to come out on this. It seems to
8 me though that there should be some limitation as to how
9 many times we can change the rules in any one decade.

10 (Laughter)

11 The Chairman. Except I do think we have an area -- at
12 least that was my intent -- to stop the churning activity.
13 And that's why we initially addressed just that area.
14 Obviously, no one wants to give up a good thing. And that
15 upsets the realtors who would rather take it out of Social
16 Security.

17 Senator Danforth. Well, I have to say that if the
18 affect of the original proposal is simply to provide less of
19 an incentive for churning, which I take it has very little
20 economic consequence other than to save on taxes -- is that
21 a fair statement?

22 Mr. Wetzler. Well, in the low income area, which you
23 dealt with earlier this morning, it's important because
24 there are special factors there because the housing programs
25 are structured so rents cannot really rise and the owners can

1 only get a very limited rate of return. And so churning
2 is important in the low income area. You have already
3 decided to exempt that.

4 Senator Danforth. Right.

5 Mr. Wetzler. With respect to the upper income area,
6 basically, I don't think any significant economic benefit
7 that comes from the churning -- it's mainly motivated by
8 the --

9 Senator Danforth. It doesn't help us modernize our
10 industrial plant. It doesn't help us provide more housing
11 or better housing --

12 Mr. Wetzler. No.

13 Senator Danforth. -- for people who need housing.

14 Mr. Wetzler. No.

15 Senator Roth. Don't you have as much churning of
16 apartment buildings as you do office?

17 Mr. Wetzler. Yes, I think so.

18 The Chairman. There are other questions, but I think
19 there is some disagreement here. I think everybody believes
20 we ought to address the problem.

21 I would suggest that we spend some time on this at a
22 Treasury staff level, and then maybe move on. I would at
23 least like to save another billion dollars before lunch.

24 Senator Heinz. Not on this subject, but I have to go
25 and floor manage the Export Administration Act at noon. And

1 you are going to take up two other items that I have a
2 particular interest in.

3 One is the four year postponement of finance lease
4 rules, which is of critical interest to the steel industry.
5 And I need to be here to discuss that with the help of the
6 committee.

7 And, secondly, as a member of the Banking Committee, I
8 need to be here to discuss the repeal, the tax exemption for
9 credit unions, which I would like to discuss. But,
10 unfortunately, I have to go over to the floor right now.
11 Would it be possible to delay those over until tomorrow
12 morning?

13 The Chairman. I think so. I think we will still be
14 here tomorrow.

15 Senator Heinz. And tomorrow, tomorrow.

16 The Chairman. No. I think we are going to try to
17 wrap this up tomorrow.

18 If there is something you can't agree on, just
19 recommend a substitute.

20 Senator Pryor. I would just like to say that I believe
21 that Senator Roth has perhaps on this issue made what I
22 consider to be a wise recommendation. And that is we attempt
23 to hold a hearing on this issue as to what we are doing in
24 changing the accelerated depreciation, the depreciation
25 schedule.

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1 I think, for example, that some of the real estate
2 people out in the country may have more sufficient infor-
3 mation than we are getting today. Now I'm not criticizing
4 the Treasury people because, as they say, this is not part
5 of their package.

6 And I'm also authorized to say by Senator Mitchell,
7 who had to leave for the floor before it got time for him
8 to speak, that he is deeply concerned about the distinction
9 we make between new and used. And so I think Senator Roth
10 has made a very good suggestion. That we hold a hearing.

11 The Chairman. I'm not certain we need hearings, but
12 I do think we need to spend some time on it. As I recall in
13 1981 when this was discussed, there was almost -- well,
14 there was a rather sharp division. I think everybody felt
15 it was a rather generous provision. I can go back and check
16 the record to see precisely who those members were.

17 Mr. Brockway. I think what happened in 1980 you
18 approved 20 years very rapidly, and 1981 it became 15.
19 There was some controversy.

20 The Chairman. We are trying to find ways to put the
21 package together. Obviously, everything is going to be
22 controversial. We are getting into areas now where there
23 are very powerful interests involved, and they are more
24 difficult to deal with.

25 Senator Danforth. Let me ask you, Mr. Chairman. Is the

1 original proposal that's in this package terribly
2 controversial?

3 Mr. Brockway. There is as much controversy about that
4 as Senator Bentsen's proposal. Anytime you split up between
5 new and used, that has some controversy. I gather Senator
6 Mitchell has expressed reservation on that. And I think in
7 the real estate industry when you split up between
8 residential and non-residential there is always concern.

9 I'm not so sure whether splitting up between low income
10 residential and other real estate creates much controversy.

11 The Chairman. We may not get \$3 billion as suggested
12 by Senator Bentsen. I think we ought to spend some time.
13 If necessary, we will have a hearing Saturday.

14 Senator Symms. Well, Mr. Chairman, if I could just make
15 a comment on this. Not very long ago I was in Arizona a
16 few years ago with Senator Matsunaga where he gave a great
17 speech on the 10-5-3. And that was a big thing. And we
18 ended up with 15 years. But it sounded good to me when he
19 talked about the 10-5-3. It looks to me like we are going
20 the wrong direction with this thing.

21 I thought our purpose was to ultimately get to 100
22 percent expensing so we could keep the books straight in
23 this country. In order to catch these few violators, you
24 really punish the small businessman that needs to go buy
25 a warehouse or something to put his potatoes in or something,

1 and then he loses the kind of a depreciation schedule that
2 we are trying to put in the tax law to encourage him to
3 expand his small business.

4 Senator Bradley. If the Senator will yield. To help
5 the small businessman expand his business by giving him a
6 10 year write-off on his structure -- if you don't want a
7 bigger deficit, you are going to have to raise the rates on
8 everybody. And I don't think you want that either.

9 I think what Senator Bentsen and Senator Dole are trying
10 to do is to try to move us a little bit away from the
11 excesses of the 1981 Act. Isn't that correct, Mr. Chairman?

12 The Chairman. Well, I'm not certain.

13 (Laughter)

14 The Chairman. I'm not certain I would state it quite
15 that way.

16 (Laughter)

17 Senator Symms. Look at the anti-churning rules first
18 before we start changing the whole set of rules.

19 The Chairman. I've asked. In fact, Senator Grassley
20 had a question on that area. And I have asked that question
21 of staff earlier. Why don't we just address the problem?
22 I don't have an answer.

23 Senator Matsunaga.

24 Senator Matsunaga. I was supposed to have been
25 recognized after Senator Danforth, you will recall, Mr.

1 Chairman.

2 The Chairman. I recall.

3 Senator Matsunaga. But since most of the questions I
4 had in mind were asked by Senator Danforth, in fact, let me
5 follow up with this. As I understand it now, the ACRS was
6 enacted for the purpose of stimulating the construction
7 industry, and to stimulate the economy. We put people back
8 to work by stimulating investments in the construction
9 industry.

10 My question now is: Now which is more important here?
11 To stimulate the construction industry? To stimulate the
12 economy? Or to stop abuses of the tax law as it now exists?
13 Which is more important from the administration's point of
14 view?

15 Secretary Chapoton. Well, I think, Senator Matsunaga,
16 the original proposal, which would deal with used property,
17 would not affect to any significant degree -- I don't want to
18 say it has no effect, but not a significant degree -- the
19 incentive affect of ACRS because it would leave it in place
20 for new property. An element in the value of new property is
21 what you can sell it for.

22 Senator Matsunaga. On what do you base that statement?
23 Have you had hearings? Have you had --

24 Secretary Chapoton. No, but we have examined the
25 dollar effect of changes in real estate again and again. We

14
1 have not had a chance to look at Senator Bentsen's proposal
2 regarding the distinction between housing and other real
3 estate.

4 This question is not new. The churning question is not
5 new in the treatment of used property. That definitely is
6 not new.

7 Senator Matsunaga. Do you limit the accelerated
8 depreciation to buildings which have actually been
9 restructured or renovated or do you allow it just on purchase
10 of an old building?

11 Secretary Chapoton. Accelerated depreciation would be
12 allowed -- all we are talking about is the life -- under
13 the staff's proposal, the life would be different. It would
14 be 20 years for a used -- that is, a building that has been
15 used before by someone else.

16 Senator Matsunaga. Yes.

17 Secretary Chapoton. And there would be an accelerated
18 deduction --

19 Senator Matsunaga. Regardless of whether any
20 construction takes place after purchase?

21 Secretary Chapoton. The additional construction is
22 treated as an additional new structure. And so additional
23 construction, I imagine, under the staff proposal, would be
24 to get a 15 year write-off. So it would be treated as a new
25 building. You would have a separate item.

1 Senator Matsunaga. Your response is that even without
2 any construction being done upon an old building, on the
3 mere purchase of a building you allow the accelerated
4 depreciation?

5 Secretary Chapoton. The mere purchase of a building
6 under existing law, you will have 15 years accelerated
7 depreciation. Under this proposal it would be 20 years
8 accelerated depreciation.

9 Senator Matsunaga. So that actually if we limit the
10 accelerated depreciation to those buildings upon which the
11 buyer performs new construction -- that is, renovation so
12 that it would serve the objective of the initial enactment
13 of ACRS, that is to stimulate the construction industry,
14 stimulate the economy -- would that rid us of the abuses that
15 have been going on?

16 Secretary Chapoton. I believe I would answer that yes
17 because the new construction, whether on an old building or
18 for a new building, would be treated the same. So there
19 would still be a significant incentive for new construction.
20 Fifteen years accelerated depreciation. Whether that new
21 construction was on a totally new building or on a used
22 building, it was purchased and renovated.

23 Senator Matsunaga. Perhaps that's an area that needs to
24 be studied.

25 And, secondly, on the credit unions, I support Senator

1 Roth in his recommendation that we do have hearings on it
2 because here again we had given credit unions the special
3 treatment in order to provide incentives for savings so that
4 we will have money for investment purposes, et cetera. And
5 I think these things need to be really studied.

6 And really I endorse the suggestion made by Senator
7 Danforth that, good heavens, we change our laws so often
8 that it causes so much instability in our business
9 communities. They don't know which way to go. And we have
10 got to exercise the leadership in lending stability to
11 American business as well as in the area of housing.

12 The Chairman. I don't have any quarrel with that. It
13 seems to me that some of these things are going to fall by
14 the wayside. But the choices are going to be harder. I mean
15 we are getting into areas now where there are very powerful
16 interests involved. And that has an impact. Maybe it isn't
17 an appropriate impact.

18 But if we are really concerned about the deficit, as
19 I assume most people in that business are -- whether
20 commercial, industrial, residential -- they had better be
21 trying to make a little contribution here, trying to help us
22 get the deficit down. You can't take it all out of Social
23 Security and Medicare and Medicaid. We've got to take it
24 out of some of the more powerful groups who don't want to
25 give up anything.

1 But I think we need to spend some time on this and
2 maybe -- there has got to be some matter we can put
3 together that would get at the abuses. I have the same
4 view as Senator Symms, and Senator Grassley who had to
5 leave. Why can't we address the abuses? And I assume if
6 we did that we would save a substantial -- now what we
7 didn't do in 1981 is to pass a bill to stimulate tax
8 shelters. And that's essentially what we have done in
9 some of these areas. May have stimulated the economy along
10 with it, but we will try to work something out.

11 I wonder if we could go to one other item before we
12 break for lunch. The Grace Commission report on where
13 somebody owes the government, where you can offset that debt
14 by withholding the refund.

15 Mr. DeArment. Yes, Mr. Chairman. One of the proposals
16 that we have been studying was a Grace Commission
17 recommendation to do precisely that.

18 This is in the package. It's in the down-payment
19 package. There is a description of all the Grace
20 recommendations.

21 The Chairman. What page is it on, though?

22 Mr. DeArment. These pages aren't consecutively
23 numbered, but if you start from the beginning and you get
24 by all of the charts, including the revenue charts, then
25 there is a package of things called "Description of Grace

1 Options."

2 And this particular one is Option Number 14, which is
3 on Page 4 of the Description of Grace Options paper.

4 Senator Matsunaga. On what page?

5 Mr. DeArment. Page 4 of the Description of Grace
6 Options.

7 Essentially what the Grace Commission is recommending
8 is to the extent that the federal government has non-tax
9 debts from taxpayers and they are in the process of sending
10 out tax refunds to those people, is that they offset the
11 debts owed to the federal government against these refund
12 checks. This is a recommendation that has long been
13 supported by the General Accounting Office and the Office of
14 Management and Budget.

15 I would say that the IRS does not favor this
16 recommendation. The IRS opposes it.

17 The Grace Commission suggested that this would only be
18 used as a collection tool of last resort. That the agency
19 that had the debt would have had to have gone through
20 routine efforts to collect the debt before notifying the
21 IRS and using this tool. And that there would be some
22 notice of provisions that would safeguard the rights of
23 the debtor in that circumstance.

24 There is only one. We do permit some offsetting and
25 only in the child support enforcement area under very

1 limited circumstances now.

2 The original Grace Commission thought that this would
3 raise over three years close to \$2 billion. The CBO's
4 analysis of the proposal is that it would raise
5 approximately \$.9 over the three years that we are looking
6 at.

7 The Chairman. As I understand, the IRS is opposed to
8 this but they oppose most everything that might work.

9 Secretary Chapoton. Mr. Chairman, I think the IRS has
10 concerns and I think we have concerns. There are a number of
11 what I would call minor concerns that the IRS becomes
12 involved in -- taxpayer disputes and things such as that.

13 I think the concern though that we all should share is
14 whether this causes a decline in compliance with the system.
15 And we do have some limited experience with the offset,
16 with the child support enforcement. And when we take a
17 control group of taxpayers who were affected by that, and
18 they are filing next year, we see a decline -- a large
19 increase in non-filers among that group. And we see
20 decreases in withholding. In other words, they file
21 statements to decrease their withholdings. They are
22 affected, in other words, by -- their tax conduct is
23 affected by the non-tax treatment of their tax information.
24 And in that case, their otherwise available refund.

25 I think we cannot ignore the fact that a change such as

1 this will affect conduct in the tax system. And that gives
2 us a lot of concern.

3 Mr. DeArment. There have been a number of studies.
4 And I think the results are conflicting. At least the
5 Grace Commission referred to a 1981 OMB study of the same
6 thing reaching a different conclusion.

7 I would say that picking the sample of child support
8 enforcement, it is not a typical debtor to the United
9 States government. These are people that have very strong
10 feelings about those debts. The only ones that we offset
11 are those that there have been substantial efforts to
12 collect against them. And they are pretty hard-boiled
13 people that feel very strongly about those debts.

14 Secretary Chapoton. Sure. No doubt it's desirable to
15 collect the debts, and no doubt it's deplorable that we
16 are giving them a tax refund at the same time they owe money.
17 But we just need to be very cautious about telling taxpayers
18 when you file your return you are doing more than simply
19 filing a return to pay your taxes; we are going to use that
20 for other purposes.

21 The Chairman. I think I can understand there might be
22 a potential problem there. But we have been trying to
23 collect some of the debts that are owed to the government.
24 Maybe this isn't the best way.

25 We had another -- I think Senator Long has an

1 interest -- in maybe another provision of the Grace
2 Commission report. And that provision, as of this morning,
3 they wouldn't give us credit for saving. Which provision
4 is that? Maybe you can just describe it.

5 Mr. DeArment. The Grace Commission made a
6 recommendation that we look to private collection agencies
7 to help in the collection of outstanding IRS accounts.
8 This is described in our material. It's item number 16
9 on Page 5 of the same material.

10 And I think Senator Long might even be prepared to
11 broaden the coverage of this to utilize private collection
12 services in areas that are beyond this collection of debts
13 that have been -- or tax liabilities that have already been
14 determined. But maybe even in connection with the termination
15 of liability.

16 Senator Matsunaga. What sort of commission is
17 recommended by the Grace Commission? Collection agents?
18 Private collection agencies?

19 Mr. DeArment. The compensation?

20 The Chairman. Ten percent, 20, 30, 40?

21 Mr. DeArment. I don't know that they have recommended
22 a percentage.

23 Senator Matsunaga. No such recommendation?

24 Mr. DeArment. Well -

25 Secretary Chapoton. I know Senator Long has asked me

1 about this several times over the last few years, and I
2 have really not received a thorough review of what the IRS'
3 problems are.

4 The one problem that is always pointed out is that the
5 private collection agencies will use different techniques
6 than the government would use. And, frankly, more heavy-
7 handed techniques, and the blame will come back to the
8 government, and particularly to the Internal Revenue Service.
9 And I think that's a concern.

10 But I do think this is something that could be looked
11 at more closely.

12 The Chairman. We don't get any savings from it
13 though?

14 Mr. DeArment. We have some people meeting with CBO
15 right this moment to try to see if we can have them
16 understand the proposal a little better.

17 Senator Long. Mr. Chairman, my thought about all this
18 has been that if you move that percentage of audits up -- you
19 say you are going to audit 3 percent now -- if you move
20 the percentage up --

21 Secretary Chapoton. No, sir, I didn't say that. I
22 was hypothetically saying that. We would not have resources
23 to increase audit above 2 percent.

24 Senator Long. You are around 2 percent now?

25 Secretary Chapoton. Lower than 2 percent.

1 The Chairman. One point seven, I think it is.

2 Senator Long. Now in the auditing that you are doing,
3 about how much revenue are you bringing in where you are doing
4 the auditing?

5 Secretary Chapoton. Senator, I just don't have those
6 figures. We can give you all those figures. I just don't
7 have them with me.

8 Senator Long. My impression of all this auditing thing
9 is that mainly you are going after people who owe --
10 taxpayers who are very successful people. Often times,
11 even somebody to make an example of.

12 But I gain the impression that just somebody making
13 \$30,000.00 or \$40,000.00 a year, that the chances are
14 overwhelming, just absolutely overwhelming compared to them
15 getting away with chiseling or tax cheating, if you want to
16 call it that, by just not reporting it properly or claiming
17 deductions that they have no real right to and that kind of
18 thing.

19 And if they found out they are not going to get away
20 with it, they would stop it. I see you are nodding.

21 Secretary Chapoton. Yes, sir, I agree with that.
22 Certainly.

23 Senator Long. Now that being the case, you ought to be
24 looking at a lot more than 2 percent of those returns. Just
25 a lot more than 2 percent. We should be looking at more like

1 20 percent. And you don't have to hire all these people on
2 the federal payroll. My thought is that you could hire all
3 the tax lawyers you want to on a contingency basis and just
4 assign them cases that you are not going to go after, but
5 have them take a look at them and see if they don't think
6 they can collect something.

7 Secretary Chapoton. Senator, I was drawing a
8 distinction between collection process and auditing process.
9 If you are talking about private agencies doing an IRS
10 audit, that's a far more reaching proposal, I think, than
11 the Grace Commission proposal.

12 Mr. DeArment. If you took resources of private
13 collection agencies, it would free up personnel for you to
14 do more audits.

15 Secretary Chapoton. From the collection process.

16 Mr. DeArment. Yes.

17 Secretary Chapoton. That could very well be.

18 Mr. DeArment. Senator Matsunaga, you had asked the
19 question about the fee that would be charged. They did not
20 recommend a fee, but in calculating -- the Grace
21 Commission -- in calculating the revenue that would be
22 gained, they assumed that there would be a 25 percent
23 commission to the collection agency. So they netted that
24 out to come out at -- they looked at the total debts.

25 Senator Matsunaga. One point seven nine.

1 Mr. DeArment. So they assumed a 25 percent fee.

2 Senator Matsunaga. I'm talking about Item 16 -- private
3 collection agencies. The \$1.79 billion estimated collection
4 in the next three years is based simply on the known
5 delinquent accounts. Is that right?

6 Mr. DeArment. That's correct.

7 Senator Matsunaga. So what Senator Long was speaking
8 of is not included in this?

9 The Chairman. No.

10 Mr. DeArment. No. His proposal would be beyond that.

11 So, basically, total delinquencies as of June 30th,
12 1980 were \$34 billion. That represents tax debts and
13 14.3 in -- about \$20 billion in tax debts and about \$14
14 billion in non-tax debts.

15 Senator Matsunaga. Well, Mr. Chairman, this is an
16 area I think we ought to pursue aggressively.

17 The Chairman. Get the CBO to give us some savings on
18 it.

19 Senator Matsunaga. Thirty-four billion. If you
20 collect 10 percent, that's \$3.4 billion. That's double what
21 the Grace Commission projects here.

22 Mr. DeArment. Yes. They made some assumptions about
23 the age of some of those debts and collectibility and
24 discounted it, and then applied a 25 percent commission and
25 came up with this.

1 The Chairman. I might say I have talked to Mr.
2 Penner this morning of CBO saying we want to -- we are not
3 looking for smoke, but if there are some savings here, we
4 ought to be given credit for it.

5 Senator Boren. Say that again. Thirty-four billion
6 is the total owed to the government that is not --

7 Mr. DeArment. That's correct. This is from the Grace
8 Commission. Total delinquencies as of June 30th are
9 \$34 billion. Of this figure, \$20.6 billion represents
10 tax debts. The remaining \$14.3 billion are non-tax debts.
11 They say that assuming that 75 percent or \$10.7 billion of
12 these debts are collectible -- so they are only assuming
13 that 75 are collectible and 25 are too old or inflated or
14 inaccurate in some way.

15 Annual collections could increase by \$600 million when
16 applying a little less than one-half of the education
17 department's success rate.

18 Senator Boren. That's a very conservative estimate.

19 Senator Bradley. It's still an awful lot of money.
20 Does Treasury agree with that number?

21 The Chairman. I think they are willing to try this.

22 Secretary Chapoton. We would have to look at the
23 numbers. I think there would be institutionally some
24 concerns about it. On a trial basis, maybe this would be
25 something to look at.

1 Senator Matsunaga. IRS agents don't work after
2 4:30, right?

3 Secretary Chapoton. I think that's not correct.

4 Senator Matsunaga. In your case, of course, there is
5 an exception. Those connected with the Congress are
6 definitely exempted from that classification.

7 But if you have private agencies that can call up
8 these delinquents at just about dinner time every night --

9 (Laughter)

10 Secretary Chapoton. The IRS has sophisticated
11 approaches and they call at dinner time and a lot of other
12 times.

13 Senator Bradley. Well, how would private agencies --
14 I mean you just turn over the name and address and phone
15 number. Would you also turn over the tax file to the
16 private agency?

17 Secretary Chapoton. No, you couldn't turn over
18 taxpayer information. It's disauthorized disclosure of
19 information.

20 Senator Bradley. So the tax return itself --

21 Mr. DeArment. These are tax liabilities that have
22 already been determined by IRS agents. All you would say
23 is that there is a \$10,000.00 --

24 Senator Bradley. Mr. Jones owes \$3,000.00; his address
25 is; his phone number. And then the private collection agency

1 would do anything they deemed to do to get the money?

2 Senator Long. Go get him.

3 Mr. DeArment. Including --

4 The Chairman. That's a big job. This is a jobs
5 program.

6 (Laughter)

7 Mr. DeArment. Instituting legal actions, wage
8 garnishments.

9 Senator Bradley. Say what?

10 Mr. DeArment. Presumably, they would use all the
11 tools that are available to the collection effort.

12 Senator Bradley. Why does the IRS oppose this?

13 Secretary Chapoton. Because I think the principal
14 reason is you -- they would use tactics that we would not
15 use. And we have problems already that agents use tactics
16 that some people think are too strong. And this could
17 exacerbate this problem.

18 Mr. DeArment. We have some safeguards to apply. We
19 already have this kind of collection activity with respect
20 to non-tax debts. It's going on right now. We have debt
21 collection acts that this Congress passed two years ago.

22 Senator Bradley. Let me ask you if this is an IRS
23 concern. And maybe it isn't a concern of the committee. But
24 let's assume you turn it over to a private collection agency,
25 and, indeed, they become excessive, right?

1 Mr. DeArment. Right.

2 Senator Bradley. You then have an enterprising
3 reporter that does a story or two about police tactics
4 used by a collection agency or whatever and suddenly
5 everybody thinks that it's the IRS that did that and not
6 some private collection agency. What ramifications does
7 that have for compliance, added to toward government
8 generally?

9 Secretary Chapoton. I think that's exactly the problem.

10 Senator Bradley. I mean obviously we all want to go
11 get the people that owe the taxes. The question is are we
12 going to shoot ourself in the foot as we go off to get it.

13 Mr. DeArment. As I indicated, the Debt Collection Act
14 now has private agencies collecting federal government debts
15 under the supervision of the particular agency. And these
16 people would be under the supervision of the IRS.

17 The Chairman. There was a unanimous vote on that bill.

18 Mr. DeArment. The Debt Collection Act.

19 The Chairman. Let's go ahead and approve the
20 provision unless there is some problem.

21 Secretary Chapoton. Mr. Chairman, could we give me
22 an opportunity -- I'm not familiar with the details of the
23 safeguards -- and maybe see if we could work with the staff
24 to make sure that we get as many as --

25 The Chairman. Could you take a look at the offsetting,

1 the refund, to see if there is any way that that might work?
2 I mean it seems to me that we don't want to reduce
3 compliance. It's so low now.

4 Secretary Chapoton. That's correct.

5 The Chairman. Could you take a look at Senator
6 Long's suggestion of what we might do in this bill to
7 increase audits? I mean could we authorize additional
8 personnel?

9 Secretary Chapoton. Well, that, of course, gets into
10 the budgeting area. You can do that. In fact, we did that
11 in TEFRA. And you can follow that approach again.

12 Senator Long. Every time we come in here to try to
13 hire more agents somebody kills that on the basis that
14 that is an expenditure of fund. But if you are talking about
15 just hiring somebody on a contingency basis where all he
16 gets is a share of what he collects -- now young lawyers
17 just do it all the time.

18 Back when I started practicing law, that's how most
19 young lawyers managed to stay alive, to hold hide and hair
20 together until they could find some clients that could
21 afford to pay. Just go sue somebody on a note.

22 (Laughter)

23 Senator Long. I don't know if an ordinary person can
24 do that. I don't know why other folks can't do it. I've
25 had experience in trying to make dead-beats paid off. And

1 you would be surprised how well it helps when they find
2 they are being sued. They hear, by golly, they have got
3 to go to court and somebody is going after them. And then
4 go out and sort of tax their property. The next thing
5 you know, they find they have got to go through all this
6 and they say they think they will pay. And so you get your
7 money.

8 And I just wanted to ask this question. You figure
9 your auditing is about 2 percent.

10 Secretary Chapoton. Less than 2 percent.

11 Senator Long. Now can you tell me based on the
12 auditing that you are doing about how much you collect by
13 doing the auditing? Basically, in terms of how much you
14 increase on the 2 percent you are examining, how much you
15 have increased the government take by doing that auditing?

16 Secretary Chapoton. I just don't have that figure, but
17 it's a very definite figure. We know the audit activity
18 yields X amount of dollars.

19 Senator Long. Well, would you get that figure for me?

20 Secretary Chapoton. Yes, sir.

21 Senator Long. I would like to know. Are we making a
22 4 to 1 return or 1 to 1 return or what return because it
23 seems to me that even if you are only breaking even --
24 when people know that when they chisel on their tax return
25 they are going to be audited and it's going to cost them

1 money to defend themselves and all the rest of it, that
2 tends to make them comply. So please provide us with that
3 information.

4 Secretary Chapoton. Yes, sir.

5 Senator Long. Profit or losing money.

6 Secretary Chapoton. I will provide that. A lot of
7 the activity and a lot of the resources now go into
8 matching of information, returns and that type of thing
9 which also yields money and also has a cost benefit
10 ratio.

11 Senator Long. All right. But when you go beyond that --
12 now that you are going to do anyway.

13 Secretary Chapoton. Right.

14 Senator Long. That will be done anyway.

15 Secretary Chapoton. And that's a prelude to audit.
16 You are correct.

17 Senator Long. Out of the money you are spending going
18 out there auditing, what is it costing and how much are you
19 getting in? I would just like to know that.

20 Secretary Chapoton. We will have that for you.

21 Senator Long. You have been in here asking for these
22 agents, and the Congress has repeatedly turned you down.
23 Somebody says that's an increase of federal expenditures.
24 Well, I say if you can't get them that way, why don't you
25 try doing it on a contingency basis. Try some and see how

1 it works.

2 It seems to me there are all kinds of things we do
3 in the government that might be a good idea and might not.
4 And you will never know if you don't try. Just find out.
5 It might work and it might not. If it works, you might make
6 a ton of money, might make billions. You keep telling us
7 that there is \$100 billion a year out there we are losing
8 because people are chiseling and cheating and not paying
9 their taxes.

10 My reaction is, well, why don't we try something we
11 have't tried up to this point. See how it works.

12 Secretary Chapoton. We will work with staff on the
13 parameters of this private collection effort, and we will
14 also provide that information for Senator Long.

15 Senator Boren. Mr. Chairman, I wonder on the situation
16 in terms of the refund -- are there situations now where you
17 are withholding money out of refund checks? I know we have
18 gotten into this area in child support enforcement and
19 others things that have been under consideration. Have you
20 had any experience with that at all in terms of --

21 Secretary Chapoton. Withholding, offset on delinquents.

22 Senator Boren. Offset on delinquent child support
23 payments. Is that the only one?

24 Secretary Chapoton. Yes, sir.

25 Senator Boren. Has that caused any --

1 Secretary Chapoton. Well, that's what I was stating
2 earlier. We have some information. A lot of people are
3 looking at this data to see what the effect is.

4 We see an impact on both filing and on withholding
5 patterns in the taxpayers affected in subsequent years.
6 A downward impact.

7 Senator Boren. I wonder if the downward impact on
8 filing, if they are filing to obtain a refund in terms of --
9 of course, I understand what you mean there. You still want
10 them to file.

11 But I would hope, Mr. Chairman, we could still look at
12 that because I'm really kind of unconvinced of the idea that
13 if we started withholding or offsetting at least a portion
14 of a debt owed that you would lose more than you would gain --
15 it seems to me you would gain a lot more than you would lose.

16 Secretary Chapoton. I think you clearly would gain
17 dollarwise on the short run. I think you've got to worry
18 about though the attitude of taxpayers and a voluntary
19 compliance system where we are necessarily going to have a
20 very low rate of audit activity, the affect on the attitude
21 toward the information they send in and the money they send
22 in, if it is used for other than tax purposes.

23 Senator Boren. I hear this all the time where
24 the taxpayers say these people owe the government money. And
25 are we doing this already in student loans? Are we

1 offsetting?

2 Secretary Chapoton. No, I don't believe so.

3 The Chairman. We are collecting.

4 Senator Boren. We are collecting. And we have had
5 that experience and that has been a relatively good
6 experience, right?

7 Secretary Chapoton. Very successful.

8 Senator Boren. Very successful. Because a lot of
9 people say that to me. Why don't you just hold it out of
10 their refund checks if they owe the government money? And I
11 don't know.

12 Again, Mr. Chairman, I would hope this is something
13 that we wouldn't just give up on. Maybe again a trial run
14 or a pilot program or something at least. But I think we
15 ought to be more innovative in trying something.

16 The Chairman. Maybe we could figure out some
17 experimental approach or something. We have to make fairly
18 difficult decisions up here, and this one doesn't seem too
19 difficult except it is an institutional problem. We don't
20 want to create more problems for you, obviously, but if
21 anybody ought to pay, it's somebody that owes the government,
22 before we go out and start taking a look at positions,
23 freeze, Medicare or 20 or 15 years or anything else. I don't
24 know how we can do it. Maybe it's not practical.

25 What can we bring back up then at 2:00? We need to

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1 start making some decisions. We've only done a couple of
2 billion this morning.

3 Mr. Brockway. On the list you still had \$5,000.00
4 expensing and telephone tax that no members had made
5 reservation with respect to.

6 The Chairman. I'm convinced we will just forget about
7 the credit unions. We will let Mr. Grace work that out with
8 them at least for this year. That will cut down on the
9 crowd this afternoon.

10 So we will come back at 2:00 and start then on maybe
11 the expensing items. Or the Grace Commission, if you can
12 get that material.

13 Mr. DeArment. Maybe Buck can have some responses.

14 Secretary Chapoton. I'm going to have to be over
15 there.

16 (Whereupon, at 12:34 p.m., the mark-up session was
17 recessed.)
18
19
20
21
22
23
24
25

AFTERNOON SESSION

(2:07 p.m.)

1
2
3 The Chairman. I think while we are waiting for other
4 members to arrive, we will complete action on the bill.

5 (Laughter)

6 The Chairman. There are a couple of noncontroversial
7 areas that I might at least describe for the record and then,
8 hopefully, when we have -- what do we need, Rod, to adopt
9 an amendment -- since we have had a quorum?

10 Mr. DeArment. Since continuation, we need five members.

11 The Chairman. As I understand, the telephone excise
12 tax and the freeze on expensing are virtually noncontroversial
13 noncontroversial. Jim?

14 Mr. Wetzler. Yes. Currently, you have got a 3 percent
15 telephone excise tax which expires at the end of 1985, and
16 the proposal is to extend it through the end of 1987. That
17 would pick up \$3.2 billion over the three-year period, and
18 then in 1981, you provided that businesses could elect to
19 expense up to \$5,000.00 of property each year, and that is
20 scheduled to go up to \$7,500.00 in 1984 and 1985, and then
21 to \$10,000.00 thereafter. And the proposal would freeze it
22 at \$5,000.00 through 1987, then increase it to \$7,500.00 in
23 1988 and 1989, and then up to \$10,000.00 after 1989 and in
24 future years. And that would raise \$1.4 billion over the
25 three-year period.

1 So, those two proposals together would be \$4.6.

2 The Chairman. Okay. We will wait until other members
3 arrive. As I understand in all the staff discussions, those
4 were not "contentious items."

5 Mr. DeArment. No, they were not contentious. There
6 are two other freeze items that we might want to look at.
7 One involves freezing at \$80,000.00 the amount of income
8 earned abroad that would be excluded. That is basically
9 \$200 million over the period. And another one would be to
10 freeze the amount of used property that could be purchased
11 and subject to which you could claim the investment tax
12 credit. Those are two additional freeze items that are
13 potentially there.

14 The Chairman. What are the revenue estimates on those?

15 Mr. DeArment. Both proposals raise about \$200 million
16 over this period of time that we are looking at.

17 The Chairman. Anything else to add to those, Jim?

18 Mr. Wetzler. Among freeze items, we have got some
19 things where we are still working on them.

20 The Chairman. We did agree on that, I think Mike
21 Stern asked the question or asked Rod -- we did agree on
22 that Federal Home Loan --

23 Mr. DeArment. There was a question as to whether,
24 when we were reviewing this, that we repeal the tax
25 exemption for Freddy Mac -- whether we had taken tentative

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1 action on that. The answer is yes.

2 The Chairman. Okay. So, there are those four freeze
3 items. I don't think they are controversial, but we don't
4 have enough here to act on them.

5 Mr. Wetzler. Now, an open issue is still the royalty
6 trust question, and Senator Bentsen is here. I don't know
7 if we want to --

8 The Chairman. Well, I think some of the other players
9 aren't here. I wonder if we might address Section 355.

10 Mr. DeArment. That is one of the add-on items.

11 The Chairman. That is one that I hope we can resolve
12 and maybe just raise it as this time and maybe we can work
13 it out then at staff level. Is that all right?

14 Mr. DeArment. Treasury --

15 The Chairman. Treasury is opposed to it.

16 Mr. DeArment. Yes.

17 Mr. Schieber. Yes. That is correct.

18 The Chairman. Right. So, at least that has been raised
19 and we hope we can -- when we get into the add-on -- in case
20 we forget that, staff will remind us.

21 What about any more Grace Commission savings? Did that
22 bear any fruit this morning?

23 Mr. DeArment. The CBO agreed to reexamine about five
24 different areas that they are going to look at, and there is
25 one additional area that they suggested that could pick up

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1 about over a billion dollars. We might want to examine that.

2 The Chairman. What area would that be in?

3 Mr. DeArment. That was involving electronic fund
4 transfer of payroll and benefit checks.

5 The Chairman. Oh, is this the speed-up of local and
6 county collections?

7 Mr. DeArment. No. No. Not that area. This is U.S.
8 benefit checks and payroll checks to require electronic
9 funds transfer of those or there would be delayed mailing
10 of those benefit checks.

11 The Chairman. Then, have we worked out some options
12 on the electronic transfer of alcohol and tobacco taxes?

13 Mr. Wetzler. Yes.

14 The Chairman. I understand there was no objection to
15 doing a portion of that. It would still raise about \$500
16 million.

17 Mr. Wetzler. We have been working on that over the
18 lunch hour, and what kind of proposal that would let them
19 have 14 days of float after each semimonthly period. If
20 the 14th day was on a Saturday, Sunday, or legal holiday,
21 returns in payment would be required in the last preceding
22 business day. And then, in addition, taxpayers who are
23 liable for more than \$5 million in alcohol or tobacco tax
24 in the preceding fiscal year would be required to pay those
25 taxes by electronic funds transfer.

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1 I think that would have the effect of giving them the
2 float, but would give us the little swing on September 30,
3 at the end of the fiscal year, which would, you know, let
4 us count some revenue savings for budget accounting purposes.

5 The Chairman. Does that apply to both tobacco and
6 alcohol?

7 Mr. Wetzler. Yes.

8 The Chairman. What kind of savings are you talking
9 about?

10 Mr. Wetzler. We are still running the numbers, but I
11 think it will be substantial. We are still working on the
12 revenue estimates, Senator Dole.

13 The Chairman. All right. Why don't we just withhold
14 on that one. Anything else you want to raise?

15 Is there anything else staff has there?

16 Mr. Wetzler. We have got a few other reform proposals
17 that we think are not especially controversial that I think
18 Treasury has worked out, and they would raise probably
19 around \$.2 or \$.3 total, but I think you might want to look
20 at those. I think most of these are not -- in fact, all of
21 them are not controversial.

22 One deals with the rules on reporting of the dividends
23 received deduction. This is a case where corporation-owned
24 stock has it on deposit at a stockbroker. The broker lends
25 the stock out because -- to a short seller -- and the problem

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1 there is that what that corporation is receiving is not
2 a dividend, because he is just receiving a payment in lieu
3 of the dividend from the short seller. If the corporation
4 received a dividend, it would be entitled to the 85 percent
5 dividends received deduction. If it receives a payment in
6 lieu of the dividend -- because its stock has been lent out
7 by its broker -- then it isn't.

8 Now, the problem that we have there is there is
9 apparently widespread noncompliance in this area with
10 basically two corporations claiming dividends received
11 deduction in connection with the same stock, and the reason
12 they are allowed--they are getting away with this--is there
13 is no positive requirement that the broker notify a
14 corporation -- its corporate customer -- that its stock has
15 been lent out.

16 So, establishing a reporting rule would, I think, be a
17 fairly modest proposal which would, I think, stop the
18 noncompliance. In cases where very large dividends are
19 being paid out is like in the Chrysler-preferred situation
20 -- there has apparently been quite a good deal of short
21 selling and quite a good deal of noncompliance, we are told.

22 The second proposal deals with a question of dividends
23 received for mutual funds. There is a safe harbor in the
24 law which says today that 75 percent of a mutual funds
25 income comes from dividends. Then, when it pays dividends

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1 to its shareholders, the shareholders can treat 100 percent
2 of what they are getting from the mutual funds as dividends.
3 Now, what has been happening is they have been setting up
4 mutual funds, especially for corporations to invest in
5 because the mutual fund will invest in 75 percent stock,
6 25 percent debt, and so, in effect, the corporation which
7 gets an 85 percent deduction when it receives dividends but
8 has to pay tax on all of its interest income is, in effect,
9 therefore able to claim the dividends received deduction
10 with respect to interest income to the extent of 25 percent
11 of the mutual funds income.

12 So, what we are proposing here is to say that, in the
13 case of corporate shareholders, you would not have that safe
14 harbor -- that they would have to, if a corporation owns
15 shares in a mutual fund, and 80 or 85 percent of the mutual
16 funds income is dividends, then the corporation would only
17 be able to claim the dividends received deduction with
18 respect to the 80 or 85 percent -- whatever the exact
19 percentage is -- rather than with 100 percent, and therefore
20 prevent this little gimmick where they claim--or convert
21 dividend into interest income for mutual funds.

22 We talked this over with the mutual funds industry, and
23 I think they are agreeable to a proposal along these lines.

24 And the third one relates to warrants, and this is a
25 case where corporations issue warrants --

1 The Chairman. What are the revenue impacts as you go
2 down the list there?

3 Mr. Wetzler. Most of these are negligible revenue
4 gains because it is hard to estimate things like the
5 noncompliance that is going on, for obvious reasons.

6 The mutual fund proposal would be a \$.2 over the
7 three-year period.

8 The next one relates to warrants, and this is when a
9 corporation issues warrants to buy its own stock, and today
10 there is some confusion in the law. And what is happening
11 is that corporations who have a gain on their warrants
12 -- which is to say the warrants lapse without being
13 exercised -- are excluding the gain. The corporations that
14 have a loss on their warrants -- because the warrants are
15 -- you know, the stock goes up and the warrants are
16 eventually -- they buy back the warrants -- are deducting
17 the loss.

18 So, the Treasury is getting whipsawed when the
19 corporation has a gain -- we get no tax. And when the
20 corporation has a loss, they deduct the loss. And the
21 proposal here is to provide that there be no gain or loss
22 on the receipt of money or property in exchange, you know,
23 for the stocks. A corporation would get no gain or loss on
24 the warrants, which is the same rule that if a corporation
25 trades in its own stock, it is no gain or loss.

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1 So, we would be treating the issuance of warrants just
2 like the issuance of stock, and I don't believe there is a
3 great deal of controversy on that proposal.

4 The Chairman. As I understand it, Treasury agrees with
5 all these.

6 Mr. Wetzler. Yes.

7 Mr. Schieber. Yes, we agree with all three of them.

8 Mr. Wetzler. The next one relates to what happens when
9 a corporation distributes an original issue discount bond as
10 a dividend. Suppose the corporation distributes to its
11 shareholders a bond that has a market value of 20 today, but
12 will pay no interest, but will pay off 100, you know, 20
13 years from now. The shareholders report \$20.00 as a dividend,
14 which is the correct result, but the corporation reduces its
15 earnings and profits by the full \$100.00, even though the
16 fair market value of what it is distributing is only \$20.00.

17 And then, in addition, apparently, the corporations
18 -- or some of them, at least -- are taking the position that
19 the \$80.00 of original issue discount is deductible as
20 interest, which by itself would not be so bad, but they are
21 deducting it apparently under the old linear rules that
22 applied prior to the TEFRA. So, the proposal here would be
23 to reduce earnings and profits by the fair market value of
24 the obligation distributed, not its face value, and then
25 clarify that the corporation accrues the interest deduction

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1 using the economic interest method that was agreed to in
2 the 1982 Act for original issue discount bonds. We believe
3 that that is the present law, but some people are taking a
4 contrary position. So, this would clarify that.

5 The Chairman. What about Treasury on this one?

6 Mr. Schieber. We agree on that one, too, Mr. Chairman.

7 Mr. Wetzler. Now, I am going to ask Mr. Sterling to
8 explain the last two, which I think get rather technical.

9 The Chairman. I thought the first one was rather
10 technical.

11 (Laughter)

12 Mr. Sterling. Item five deals with the definition of
13 certain reorganization transactions under present law.
14 It is now a device that occurs with some regularity where
15 a corporation with sizable earnings and profits will
16 liquidate, and many of the shareholders will take the
17 operating assets of the corporation and put them into a
18 new corporation but keep the cash of the old corporation
19 in their own hands.

20 That transaction looks very much as if the dividend
21 -- the cash that is retained by the shareholders -- should
22 be treated as a dividend, but the service doesn't have a
23 real good way to tax that as a dividend. This proposal
24 would say that, if there is a 50 percent overlap between the
25 shareholders of the old corporation and the shareholders of

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1 the new corporation, that the service could more easily tax
2 the cash that remains in the individual's hands as a dividend
3 rather than as capital gain.

4 The Chairman. These are not on --

5 Senator Bentsen. Do you have anything that we can refer
6 to?

7 Mr. Wetzler. No, these are not on a written sheet.

8 The Chairman. Can you have copies of those made?
9 These are the ones that the Joint Committee, I understand,
10 are working with Treasury and the staffs, are of a rather
11 minor nature.

12 Mr. Wetzler. Yes. This was called from a much longer
13 list of ideas, many of which emanated from the Senate
14 Finance Committee Staff, Subchapter C Study that are
15 considered not controversial, and the Treasury is willing
16 to support.

17 The Chairman. Let's get a copy.

18 Senator Bentsen. It is very hard for us to pass
19 judgment on them without having a chance to look at them.

20 Mr. Wetzler. We will get you a copy. I think they
21 are making copies of this sheet.

22 Senator Bentsen. What is noncontroversial to one
23 person may be controversial to someone else, I have found
24 around here.

25 Senator Moynihan. I have got some noncontroversial

1 amendments I would like to pass around here.

2 The Chairman. We need two more members here to take
3 any action. While we are waiting for copies, is Treasury
4 going to be working on that offset refund?

5 Mr. Schieber. Yes. We are going to meet as soon as
6 we are finished this afternoon. The Commissioner is on his
7 way up. Hopefully, we will be able to discuss those
8 afterwards.

9 The Chairman. The Commissioner will say no. We know
10 what he will say, but I must say there is a great deal of
11 support for that on the committee, and we would rather not
12 force the issue if we can figure out some way to avoid it.

13 Mr. Schieber. I think our preference would be to
14 discuss the collection agency alternative, but obviously,
15 we hope to discuss both of them.

16 The refund offset is of great concern both to the
17 Commissioner and to us. We would like to take a run at
18 the collection agency alternative first and see if that
19 does have the desired effect of a positive reallocation of
20 resources and try it on an experimental basis and make sure
21 the safeguards against collection excesses are there in
22 place, before we begin an expanded refund offset program.

23 And that will have the benefit of also giving the
24 child support refund offset program a little longer to
25 operate, so the data on noncompliance will be a little better.

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1 We are operating on not very good data now.

2 The Chairman. Let's see. Do we have the copies?

3 Mr. Graham. Mr. Chairman, we received a report from
4 Mr. Stockman, the Budget Director, concerning the
5 effectiveness of the 1982 Debt Collection Act. And their
6 conclusions are that in 1983 the increase in the Federal
7 delinquent debts was held to a 3 percent increase, and this
8 is compared to a 32 percent increase in 1982. And at this
9 point, they have attributed about \$2.7 billion directly to
10 the Debt Collection Act of 1982.

11 The Chairman. That is why I think we are so interested
12 in the other -- either the agency collection or the offset.

13 Mr. Schieber. Hopefully, we will make some progress
14 in our discussion this afternoon.

15 The Chairman. All right. Now, we have this brief
16 summary sheet. I assume that-- Let's see, you were in
17 the process of explaining number five. Is that correct?

18 Mr. Sterling. Yes, sir.

19 The Chairman. I don't understand it.

20 Mr. Sterling. Would you like me to try again?

21 The Chairman. No, I think you did a good job.

22 (Laughter)

23 The Chairman. But you might try it again because now
24 we have at least an indication of what it is in writing.

25 Mr. Sterling. Very good. Item number five is designed

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1 to deal with one loophole that exists under present law,
2 where a corporation will liquidate and then reincorporate
3 in a new corporation --

4 Senator Bentsen. I believe in the interim you leave
5 a bunch of --

6 Mr. Sterling. Right.

7 Senator Bentsen. And that doesn't go into the second
8 corporation. I think you can get by with capital gains if
9 there is as much as 50 percent continuity in ownership.
10 Then you want to be able to tax that cash on an ordinary
11 basis. Is that about it?

12 Mr. Sterling. That is correct, Senator.

13 The Chairman. Any problem with that? Now, move onto
14 the next one.

15 Mr. Sterling. Item number six deals with what is called
16 a "C" reorganization under present law. A C reorganization
17 involves the transfer by a corporation of substantially
18 all its assets to another corporation solely for voting
19 stock of the acquiring corporation. Under present law,
20 there is no requirement that the corporation that sold its
21 assets be liquidated, and therefore, under present law,
22 the company that sold its assets can remain in existence
23 with the stock of the acquiring corporation as its assets.

24 In a situation where the acquired corporation can
25 remain in existence, just having undergone a reorganization,

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1 all its corporate tax attributes will pass to the acquiring
2 corporation with the result that the corporation that has
3 sold its assets will have no tax attributes, no earnings
4 and profits for example. As a result, that corporation can
5 more easily pay distributions to its shareholders which
6 would not be taxed as dividends because it has no earnings
7 and profits.

8 This proposal is, I think, a very narrow proposal that
9 says that -- in a C reorganization -- the company that sells
10 its assets has to be liquidated to be entitled to the
11 benefits of the reorganization rules.

12 Senator Bentsen. It seems to me that that is a
13 reasonable proposal.

14 Mr. Sterling. I am aware of no controversy on it.

15 The Chairman. All right. So, these five minor -- these
16 changes -- would total up to what?

17 Mr. Sterling. These total up to about \$.2. I don't
18 think any of them are very large revenue items.

19 The Chairman. Why don't we --

20 Senator Bentsen. What does \$.2 mean?

21 Mr. Sterling. \$200 million over the 1985 through 1987
22 period. You may want to let these sit out for a while and
23 see if anybody raises an objection to them.

24 Senator Bentsen. I just wanted to understand what a
25 not significant amount of money meant.

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1 Mr. DeArment. This is \$200 million.

2 The Chairman. Over three years?

3 Mr. DeArment. That is still significant for some of
4 them.

5 The Chairman. Over three years?

6 Mr. DeArment. Yes. Three years.

7 The Chairman. While we are waiting for a couple of
8 other members, I would like to take action on these eight
9 or nine items that are pending. Did HHS agree that we
10 should go ahead on that other spending proposal? Is Sheila
11 around?

12 Have you had a chance to look over that little nugget?

13 Ms. Kelly. Yes.

14 The Chairman. Are you for it or against it? Do you
15 support it?

16 Mr. Helms. Yes.

17 The Chairman. All right. Come on up, then.

18 (Laughter)

19 Mr. Helms. I am Robert Helms, in Planning and
20 Evaluation in the Department of Health and Human Services.
21 We are supportive in principal, but we do have some concerns
22 about it.

23 The Chairman. Explain what it is again for the record.

24 Mr. Helms. The proposal is to try to do something
25 about the problem of revaluation of hospital assets. There

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1 has been a recent case where one hospital had purchased
2 another chain, and in the process by the Medicare rules,
3 they are able to charge off more interest and also to
4 depreciate at a more rapid rate at a higher value.

5 So, we think this is a problem, and we would like to
6 work with the committee on coming up with some kind of
7 language to try to stop the problem but take care of the
8 other hospitals which might want to merge for some
9 legitimate reason.

10 The Chairman. Sheila, we are on the assets matter that
11 you raised yesterday. Senator Heinz raised it later on in
12 a substitute amendment. As I understand it, HHS has no
13 objection -- it is a matter of working out some language.
14 Is that correct?

15 Mr. Helms. That is right.

16 The Chairman. Are you working on language with the
17 Department?

18 Ms. Burke. Yes, sir. We were informed yesterday that
19 the Department has some substantive problems with the
20 proposal. If indeed it is simply a language issue, we can
21 certainly work that out.

22 The Chairman. Okay. Let's go ahead and work toward
23 that objective -- agree to that and then try to work it out.
24 We can put that on our blackboard.

25 While we are waiting for one other member, maybe we can

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1 take up Senator Baucus' and Senator Moynihan's amendment on
2 automobiles.

3 Senator Baucus. Mr. Chairman?

4 The Chairman. I wasn't in the primary -- that was
5 another guy.

6 Senator Baucus. Can we act on that now? How many
7 members do you need to act? Do you want to go ahead and
8 bring it up now?

9 The Chairman. I think we can go ahead and bring it
10 up now and discuss it. As soon as one more walks in, we
11 will have enough to act.

12 Senator Baucus. Mr. Chairman, this amendment does
13 close a loophole. It provides that the ACRS and the
14 investment tax credit will not be available to luxury cars
15 as a business matter when the value of the car is above
16 \$15,000.00 per car. The idea is that some people abuse
17 the business deduction provisions in the Code and they buy
18 luxury cars, and with the threshold level at, say, \$15,000.00,
19 then people who need the cars and want to buy those kinds
20 of cars can still do so, but for the value above \$15,000.00
21 they will no longer be able to expense those cars.

22 The revenue estimate is, I think, for a five-year
23 period roughly \$.5 billion. I have checked with CRS, and
24 CRS believes that there are no GATT problems since this deals
25 with income tax, not excise tax. And frankly, Mr. Chairman,

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1 I think it is a good matter. It is a good way to kind of
2 close down one loophole which I think is bothering some
3 Americans, and I suggest that we adopt it.

4 Senator Moynihan. If I can say, Mr. Chairman, there
5 may not be large sums of money involved here, but there are
6 large principles. The newspaper car advertisements in most
7 cities right now are just filled with tax relief invested
8 in a BMW, and for \$109,000.00, we estimate \$109,000.00 Rolls,
9 for example, would have \$53,000.00 worth of tax deduction.

10 And it just becomes a symbol of who uses the Tax Code
11 and for what purpose. You can buy a perfectly good American
12 automobile to get you back and forth from work for \$15,000.00.
13 If they want to spend more, let them spend more, but let them
14 not just take it as appreciation, in a situation where you
15 would not make that decision if it were not for the taxes.

16 And the GATT question has been raised, and the CRS is
17 very specific -- I think Mr. Wetzler agrees -- that the
18 GATT provision of this kind does not refer to income tax.

19 Mr. DeArment. Our trade staff has examined the GATT
20 question at \$15,000.00 and doesn't believe that there is a
21 GATT problem as you proposed it.

22 Senator Baucus. Mr. Chairman, while Senator Moynihan
23 is showing you that, I might say let's take a \$43,000.00
24 luxury car. The cost recovery in that whole first three
25 years combined with the investment tax credit for a taxpayer

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1 in the 50 percent bracket would yield benefits of over
2 \$21,000.00. These tend to be cars, too, which sometimes
3 appreciate in value, so the taxpayer could then sell it.
4 Sure, he would have to pay a gain on it because the basis
5 has been reduced by that amount, but the net result is
6 that people buy and sell these cars to some degree because
7 of the tax advantages, in addition to their lifestyle that
8 they want to pursue, but it just doesn't seem that for
9 business purposes that for values \$15,000.00 and above
10 should be part of this same business tax treatment as for
11 another car which definitely can be used for business
12 purposes.

13 Now, a question here, too, is does it cover vans and
14 pickups and so forth, and it is our intention that it
15 absolutely does not. We tried to draft it in a way -- and
16 it my understanding that the staff can draft it in a way
17 -- so that it applies only to luxury cars, not to pickups
18 and vans and so forth.

19 Senator Moynihan. Only cars used to transport people.

20 The Chairman. Right.

21 Mr. Wetzler. Could I just clarify, Senator Baucus,
22 you are saying that if you buy a \$16,000.00 car, you get
23 to depreciate and get the investment credit on the first
24 \$15,000.00, but not on the excess above \$15,000.00?

25 Senator Baucus. That is correct. Right.

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1 Mr. Wetzler. And in our estimates, that would raise
2 \$500 million over the three-year period, 1985 through 1987.

3 Senator Baucus. That is right.

4 The Chairman. What about other things that may be
5 used in business -- airplanes and -- In other words, are
6 you going to say that you can only buy a certain price --

7 Senator Moynihan. I don't know if I speak with knowledge
8 but I would like to put in a proposition. Airplanes are
9 not purchased in terms of their -- their sort of prestige
10 value and their sort of on-the-edge of luxury qualities.
11 My impression is that businesses that acquire airplanes do
12 so in terms of how well they perform and how fast they can
13 fly and how safe they are.

14 The difference between a \$200,000.00 airplane and a
15 \$400,000.00 airplane is a different kind of operation. And
16 my point would be that I think we should not include airplanes
17 in any circumstance.

18 The Chairman. That is just a question I thought of.

19 Senator Moynihan. Well, I honestly do think you buy
20 airplanes in terms of safety and in terms of performance
21 where there is nothing like that between a \$15,000.00
22 limousine and a \$150,000.00 limousine.

23 The Chairman. If you will excuse me, I will be back in
24 a couple of minutes.

25 Senator Bentsen. I am curious as to how far you go on

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1 this. Where would you draw the line as to whether they
2 rent \$20.00 a square foot office space of \$30.00 a square
3 foot office space? Whether they stay in a Holiday Inn or
4 they stay in something that is more expensive. Do you move
5 into those areas in addition?

6 Senator Moynihan. I don't think you get into the area
7 of appreciation and investment tax credits in those areas.

8 Senator Bentsen. No, but you get into the question of
9 expensing, and I am not sure how far the two are apart.
10 That is my curiosity

11 Senator Baucus. It is my understanding that we are just
12 talking about when we get right down to where the necessary
13 business expenses are available -- the full value of the car.
14 The question is whether it is an ordinary business expense
15 today, regardless of the value of the car. So, those kinds
16 of questions are questions that serve as a basis regardless.

17 So, we are just saying here now that if the value of
18 the car is \$15,000.00 and above, you will get into that
19 question.

20 Senator Bentsen. You make the decision for the service,
21 in effect, is what you do on this, don't you?

22 Senator Baucus. Only for the value above \$15,000.00.
23 That is correct.

24 Senator Bentsen. And that is why I am asking how far
25 do you want to go? Do you want to get into the question of

1 the kind of accommodations at the Holiday Inn or something
2 that is more expensive? Do you want to make the judgment
3 for IRS as to value per square foot of office space? Is
4 that something that we should not expense above a certain
5 dollar per square foot?

6 Senator Moynihan. We don't propose to go any further
7 than this particular subject which has become an advertisement
8 form of taking advantage of the Tax Code in ways that you
9 otherwise wouldn't ordinarily do. The difference in what
10 it costs you at \$20.00 a foot and at \$30.00 a foot bears
11 directly on your profits and losses column -- it doesn't
12 go through accelerated appreciation and investment tax
13 credit.

14 Senator Bentsen. But, of course, it goes into your
15 expense. And you have a tax benefit as a result of that.
16 This is an interesting field that you have proposed, and
17 you have at the present time, of course, judgment being
18 exercised by the IRS whether it is proper or abusive.

19 The point is do we then take over part of that and
20 mend it? That is the question.

21 I would be interested in hearing how Treasury answers
22 that.

23 Mr. Schieber. Senator, we are very sympathetic and
24 interested in the concept that is being articulated, and as
25 I understand the concept, it is to try to --

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1 Senator Bentsen. We want to get at the abusers.

2 Now, the question is do we legislate it?

3 Mr. Schieber. Right. Maybe there are two possible
4 abuses. One is specifically addressed by the bill and that
5 is the lavish -- or the so-called lavish -- or extravagant
6 expenditure, and the other abuse, particularly with cars,
7 is the extent to which company-owned cars are used for
8 personal use.

9 While I don't have any data in front of me, I suspect
10 that if you wanted to address an abuse involving company
11 cars, the more serious abuse, the more pervasive abuse is
12 the extent to which company cars are personally used and
13 the very difficult task that the Revenue Service has in
14 dealing with the personal use problem.

15 Our concern, I think, with the bill -- because there is
16 a concern -- we have a concern -- about the lavish or
17 extravagant expense -- our concern with the bill is, as you
18 have pointed out, there are other types of assets which are
19 appreciable assets -- not hotel rooms -- but carpeting and
20 fine furniture in an office, and so forth that can be just
21 as lavish and just as extravagant, and to single out cars
22 simply because they tend to be the most visible and the
23 most publicized abuse does not seem to us to be the most
24 sensible, evenhanded way to address a broader question.

25 So, I guess our reaction would be we think the issue that

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1 the bill goes to is one that should be addressed. We would
2 like to try to do it in a way that does it a little more
3 broadly and a little more evenhandedly, and I think we would
4 be as interested in trying to see if there is something that
5 can be done in the statute to deal with this very difficult
6 factual problem of personal use of company assets.

7 Senator Bentsen. There is no question but that there
8 are abuses and great extravagances, and we ought to try
9 to curb the tax system being used for that purpose. And I
10 share with you the concern as to how do you get to this.
11 How do you accomplish it? Up to now, we have left it to
12 the IRS to determine when there is an abuse and an
13 extravagance in that regard.

14 Senator Chafee. Am I correct in my understanding that
15 the IRS has taken some of these cases involving luxury
16 automobiles to the courts and always loses?

17 Mr. Schieber. You are correct that these cases do get
18 litigated. I can't represent whether they always lose.
19 Cases involving --

20 Senator Chafee. Well, the word always is too definitive.

21 Mr. Schieber. Cases involving the reasonableness of
22 this type of expense are very difficult factual cases. They
23 are tough to deal with.

24 Senator Chafee. You know, it seems to me that while we
25 can say where do we draw the line between an automobile or

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1 the furniture or the paintings or the carpeting, it is true
2 that each of those is difficult, but I don't think that is
3 necessarily reason for not starting somewhere. Maybe
4 \$15,000.00 is not a right amount. I a co-sponsor of the
5 legislation, so naturally, I support it but I am not wedded
6 to \$15,000.00. I don't know whether the chief sponsor is
7 either.

8 But it does seem to me that here is something that we
9 can reach out and grab a hold of and it doesn't solve
10 maybe the more pervasive problem which is the use of the
11 automobile, vis a vis the cost of it.

12 The use of it is where -- I mean the use for nonbusiness
13 purposes -- but I think we ought to make a try on this, and
14 whether it is \$15,000.00 or not, that is up to the sponsor.

15 Senator Packwood. What are we on?

16 Senator Chafee. We are on automobiles.

17 Senator Packwood. Okay.

18 Senator Chafee. We spend disproportionate amounts of
19 time on the least important of the issues. The least
20 important the issue, the more time we spend on it.

21 Senator Baucus. I agree with the chairman. So, let's
22 just adopt it.

23 Senator Chafee. I don't know what the chairman wants
24 to do. Is he waiting for a quorum?

25 Senator Moynihan. We now have a quorum.

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1 Senator Chafee. We may have five, but let's wait for
2 one more.

3 (Laughter)

4 Senator Moynihan. Can I, then, just make a point?
5 We are advised that \$15,000.00 is the--if you go beyond
6 \$15,000.00, you could be in trouble with GATT because you
7 would cease to involve American cars as well.

8 Senator Chafee. All right.

9 Senator Moynihan. You would wipe out all American cars.

10 Senator Chafee. Do members have other items they wish
11 to discuss?

12 Senator Moynihan. Mr. Chairman, this minimum tax
13 proposal we have put in, I think Mr. Brockway is prepared
14 to talk about it and Mr. Wetzler.

15 Senator Chafee. All right. Mr. Wetzler, that is what
16 we were on yesterday.

17 Senator Moynihan. And it was agreed -- Mr. Danforth
18 isn't here -- but his staff and ours and Wetzler's committee
19 met last night and they have a minimum tax proposal.

20 Mr. Wetzler. If you would like, Senator, we have got
21 a handout which we prepared working with your staff,
22 describing the proposal. Would you like to have that?

23 Senator Moynihan. Could I just ask something? Mr.
24 Danforth isn't here.

25 Senator Chafee. Isn't Mr. Danforth here? All right.

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1 Why don't we put that off until he is here. He will be here
2 in 10 minutes, I understand.

3 Is there anything else that somebody has?

4 Have you discussed the charitable contribution one?

5 Senator Moynihan. No.

6 Senator Chafee. The 25 percent credit.

7 Senator Packwood. No, and I don't know if it is the
8 Chairman's intention to get to that, but let me see who is
9 here. I think it is okay to get to it now.

10 Senator Chafee. We are not going to have a vote on it
11 right now.

12 Senator Packwood. No.

13 Senator Chafee. All right.

14 Mr. DeArment. Senator Chafee, there were a number of
15 items that we had talked about and then passed over because
16 there was --

17 Senator Chafee. All right. Let's start through them.

18 Senator Moynihan. I have a small, useful little
19 proposal I can talk about.

20 Senator Chafee. All right. Let's hear it.

21 Senator Moynihan. This is the question of the
22 disallowance of certain expenses where a taxpayer uses
23 property similar to properties owned by the taxpayer --
24 sloughing.

25 Senator Chafee. Do we have this in printed material?

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1 Senator Moynihan. I believe. It is a bill I have
2 introduced, and I believe the staff knows about it. Yes.
3 Mr. Hardee knows about it. Mr. Chairman, this is a
4 proposition --

5 Mr. Hardee. All there is is Senator Moynihan's bill.
6 There has been no staff material summarizing the provision
7 yet.

8 Senator Chafee. Before embarking on something new like
9 that, why don't we finish up with the things Mr. Belas was
10 touching on and Mr. DeArment. Let's go through those and
11 then we will get to something new, and if we don't get to
12 it today, Senator, do you think you could get a piece of
13 paper that describes it a little? With the pros and cons?

14 Senator Moynihan. Right.

15 Senator Chafee. Meanwhile, Mr. DeArment, why don't
16 you go ahead?

17 Mr. DeArment. Yes.

18 Senator Chafee. Tell us your page where you are working
19 from.

20 Mr. DeArment. If you look at our set of materials,
21 if you would just look at the last page, I think, of all
22 the materials. We talked about two items. It is page 6.
23 There were two freeze items that we had discussed before
24 there was a sufficient number of members to act on it.

25 One was an extension of the telephone excise tax

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1 through 1987 at the current level. And the second one was
2 to freeze expensing of business assets -- now you can expense
3 up to \$5,000.00 a year of personal property, and this would
4 freeze it at \$5,000.00, rather than allowing it to go up
5 to \$7,500.00 and \$10,000.00 after 1985.

6 Senator Chafee. Why don't we do one at a time? Do
7 the telephone one first.

8 Mr. DeArment. Okay. The telephone tax extension is a
9 simple extension for two years of the 3 percent telephone
10 excise tax. It would raise \$3.2 billion over this period
11 of time -- over those two years.

12 Senator Chafee. That thing was meant to expire years
13 ago, wasn't it? We keep extending it, don't we?

14 Mr. DeArment. We extended it last in TEFRA.

15 Senator Chafee. Any discussion?

16 Senator Bradley. Discussion on this provision??

17 Senator Chafee. On this provision.

18 All right. Now, on to the next one. We will vote on
19 these as soon as the chairman gets back.

20 Mr. DeArment. If there is no objection to it, maybe
21 you could just agree to it.

22 Senator Bradley. Mr. Chairman, have we discussed this?

23 Senator Chafee. All right. Let's do the telephone one
24 first. Any objection to the telephone one?

25 (No response)

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1 Senator Chafee. All right. Consider that passed.

2 Now, on to the next one.

3 Mr. DeArment. The next one is limiting expenses of
4 business equipment to \$5,000.00. That proposal would
5 basically freeze it at \$5,000.00 through 1988 and then
6 resume the -- through 1987 -- and then resume the phase-in
7 that we had agreed to.

8 Senator Chafee. All right. Treasury, do you want to
9 speak on that?

10 Mr. Schieber. We are in support of that provision, Mr.
11 Chairman.

12 Mr. DeArment. That raises \$1.4 billion over this
13 period of time.

14 Senator Bradley. That means if you are a small business
15 and you expand or invest in your firm with a capital asset,
16 that you can't write off more than what?

17 Mr. DeArment. \$5,000.00 in the first year.

18 Senator Bradley. As opposed to \$10,000.00?

19 Mr. DeArment. As opposed to-- It would be \$7,500.00
20 this year and then the following year it would be \$10,000.00.

21 In that case, the business could take the investment tax
22 credit and ACRS treatment which, on a present value basis --

23 Senator Bradley. So, how much is the difference between
24 what a small businessman can take now under the law as
25 written and what he or she would be able to do after these

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1 changes?

2 Mr. DeArment. It would be \$2,500.00 this year and
3 \$5,000.00 in 1986.

4 Senator Chafee. Any objection? We are on page 6,
5 A2. Expenses.

6 Senator Boren. It would go to \$10,000.00 otherwise
7 under the current law?

8 Mr. DeArment. It would phase up to \$10,000.00. If
9 you look at the last page of the materials, it gives the
10 phase-in pattern. It would go to \$7,500.00 in 1984 and in
11 1985--\$10,000.00 after 1985 under current law. And what
12 we would propose is that we would just keep it at \$5,000.00
13 until 1988 when it would go to \$7,500.00 and then it would
14 go to \$10,000.00 in --

15 Senator Boren. This is on any piece of equipment?

16 Mr. DeArment. This is on any piece of equipment that
17 is purchased.

18 Senator Boren. Any size business?

19 Mr. DeArment. That is right, but it was used as a
20 small business item, but it is for anybody, and it is
21 basically limited per year to \$5,000.00, so you can take
22 up to \$5,000.00 --

23 Senator Boren. What is the rationale for making the
24 change other than raising the revenue?

25 Mr. DeArment. This is just freezing it at a current

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1 level basically because we are freezing most all of these
2 benefits that were added in TEFRA. There are some small
3 business groups, including the NFIB, that thought that this
4 was a bad provision. They thought it was better for small
5 business to take the investment tax credit and ACRS which
6 actually gives more tax benefits than expenses. And they
7 thought that this was a sort of a trap for the small business
8 but it has some simplicity for the small business.

9 Senator Boren. Small business has the option.

10 Mr. DeArment. That is exactly right.

11 Senator Boren. I don't have any objection to it.

12 Senator Chafee. Any objections?

13 (No response)

14 Senator Chafee. Okay. That is agreed to. Let's go
15 to the next one. We have picked up \$4 billion.

16 The Chairman. Before I left, when Senator Bentsen and
17 I were here, we went over about five minor areas that raised
18 a total of \$200 million over three years. If you could go
19 through those again.

20 Mr. Wetzler. In front of you, then, you should have a
21 sheet of additional corporate reform proposals. The first
22 one of these is --

23 The Chairman. These are all technical and there are
24 five items that I think were discussed when Senator Bentsen,
25 Senator Moynihan and myself were present.

1 Mr. Wetzler. This is a document entitled "Additional
2 Corporate Reform Proposals" -- there are six items on there
3 starting with dividend reporting rules.

4 The Chairman. Why don't you go over them very quickly
5 then, Jim?

6 Mr. Wetzler. The first one is a few compliance
7 provisions that involve reporting by stockbrokers when
8 corporate customers have their stock on deposit at the
9 broker.

10 The second deals with the safe harbor of dividends from
11 mutual funds when some of the mutual funds income is interest
12 and some is dividends, and this would basically increase
13 that amount from 75 percent to 95 percent.

14 The third deals with providing there is no gain or loss
15 when corporations deal in their own warrants, conforming
16 the treatment to what it is when they deal in their own stock.

17 The next deals with the defects of distributions of
18 original issue discount bonds by corporations.

19 The next deals with increasing the control requirement
20 for D reorganizations.

21 And the last deals with C reorganizations and the
22 requirement that there has to be a liquidation.

23 The Chairman. Some of those are technical.

24 Senator Chafee. Do they produce much revenue?

25 The Chairman. Five produced \$200 million over a

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1 three-year period, but they are areas where the Joint
2 Committee, the Treasury, and the Finance Committee staff are
3 in total agreement that changes ought to be made. I
4 understand that, unless there is no objection, one member
5 would like to take a look at number five.

6 If there are no objections, we might adopt the other
7 five.

8 Senator Moynihan. Mr. Chairman, I would like to pride
9 myself in being particularly enthused by the proposition
10 that control for means of a nondivisive D reorganization
11 would be refined to mean 50 percent rather than 80 percent.

12 The Chairman. Well, Lloyd explained that one to me
13 in about one line.

14 (Laughter)

15 The Chairman. Without objection, then number six will
16 be held in abeyance.

17 Now, where are we? Are we back on the cars? What
18 happened to the cars?

19 Senator Moynihan. It was adopted by a voice vote.

20 Senator Chafee. We had a little discussion of it, and
21 we are ready to vote.

22 The Chairman. I think Senator Bradley wanted to --

23 Senator Chafee. Senator Bradley wanted to be heard on
24 it.

25 (Pause)

1 Senator Chafee. What about A3?

2 The Chairman. Which one?

3 Senator Chafee. A3. The one after expensing.

4 Mr. Wetzler. I think, Senator Chafee, that several
5 Senators wanted to be present when that was brought up.
6 Senator Heinz and Senator Durenberger.

7 The Chairman. Was that the leasing?

8 Mr. Wetzler. It involves leasing, yes.

9 Senator Bradley. Mr. Chairman, are we on automobiles?

10 The Chairman. We are back on automobiles. I mean that
11 is a quote.

12 Senator Bradley. Luxury?

13 The Chairman. Right. That is what it says here --
14 luxury automobiles.

15 Senator Bradley. I missed the earlier discussion. What
16 is the rationale for doing this with automobiles and not
17 doing it for vacation homes, second apartments, Lear jets,
18 yachts -- you know, the list is endless. The question is
19 why automobiles?

20 Senator Chafee. I think the rationale was that it is
21 possible to do the others. However, this is one specific
22 thing -- we got into furniture, we got into how big your
23 quarters are going to be, how luxurious they are -- and it
24 could go on forever. But here is one specific that I, for
25 one, think we ought to tackle.

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1 Senator Baucus. If you are talking about rationale
2 bills, you might as well start here. I mean, you have to
3 start somewhere. There are probably abuses, and we all know
4 there are abuses in other areas, but here is one that is
5 pretty clear.

6 Senator Bradley. What I would like to do if we could
7 -- could the Treasury give us a list of other candidates
8 here, with the appropriate number? If \$15,000.00 is the
9 number, maybe in cars it should be \$20,000.00 or \$18,000.00.
10 Why \$1,500.00, and I think that while you are doing that,
11 -- to confirm that that is the appropriate number -- you
12 ought to give us a ballpark figure on Lear jets and yachts
13 as well and a revenue estimate and maybe on vacation homes.
14 Suits.

15 The Chairman. Suits?

16 (Laughter)

17 Senator Bradley. I have never even been in that
18 league, so I don't know.

19 Senator Bentsen. Well, maybe we ought to figure out
20 the square foot value of the Hart Building and what our
21 offices --

22 (Laughter)

23 Senator Bradley. I think what Senator Bentsen said
24 just takes us to the absurdity that it is. I mean, why do
25 we want to single out automobiles here and nothing else?

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1 I mean, what is the rationale for automobiles, other than
2 it appears on our list?

3 Senator Moynihan. Bill, would you allow one thought,
4 and that is that automobiles have been singled out in the
5 advertising. And there is a question of the appearance of
6 the --

7 Senator Bradley. Singled out why, Pat?

8 Senator Moynihan. They have been singled out. At BMW
9 of Fairfax, tax relief --

10 Senator Packwood. My hunch is that they are singled
11 out -- I will just take a guess -- to the extent that there
12 is an abuse, they are probably 90 percent of the total cost
13 of the abuse.

14 Senator Bradley. If the rationale is any tax shelter
15 similar to this that has been advertised should be on this
16 list, you know we can add quite a few exotic proposals to
17 the list. I mean, I happen to think that this is --

18 Senator Moynihan. Now is the time to do it.

19 Senator Baucus. That is right. Just because there is
20 one abuse, it doesn't mean that we shouldn't look into other
21 abuses.

22 Senator Bradley. Fine. What is the cost of the Lear
23 jet? Does Treasury know?

24 (No response)

25 Senator Bradley. And what is the cost of the yacht?

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1 (No response)

2 Senator Bradley. I mean, the point is that this is
3 de minimum revenue. It is largely symbolic as much as the
4 actions that we are taking here -- simply creating new
5 opportunities. And I think it is an illusion to think that
6 this is a blow for tax reform. I mean, if we are going to
7 go this way, let's close a few more.

8 Senator Packwood. Fine. Close them.

9 Senator Bradley. Does Treasury have the number on Lear
10 jets and yachts? I mean, I haven't priced them recently,
11 so --

12 Mr. Schieber. Well, Senator, neither have we.
13 We can't give you that now.

14 Mr. Belas. Some corporate business jets can range
15 anywhere from \$3 million on up.

16 Senator Bradley. \$3 million on up?

17 The Chairman. They go up pretty high -- a lot of them.

18 (Laughter)

19 The Chairman. Does Treasury support all this stuff?

20 Mr. Schieber. We are with you in spirit, but --

21 (Laughter)

22 Mr. Schieber. I think Senator Bradley articulates our
23 concern, Mr. Chairman. We, too, are concerned about the
24 targeting of one item and saying that that is a luxury item
25 and that, if a car costs over \$15,000.00, that is

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1 extravagant, but some other item like fancy furniture in an
2 office is not extravagant, notwithstanding its cost.

3 I think there is a problem in the law now of
4 extravagant expenditures which receive tax benefits, and
5 I think that needs to be dealt with. I don't have an answer
6 as to how to do that. I would prefer, very frankly, since
7 it does not raise a great deal of revenue, to try to work
8 with the sponsors to see if we can deal with the problem
9 on what I would suggest would be a broader, more rational,
10 more evenhanded, if you will, basis.

11 Senator Bentsen. As I recall, we tried to deal with
12 the three-martini lunch. That was one of our problems before.

13 Mr. Schieber. I think this is an area --

14 The Chairman. We dealt with that for a couple of days.

15 (Laughter)

16 Mr. Schieber. You know, you are on the fringe of the
17 fringe benefit rules and they are very difficult to deal
18 with.

19 The Chairman. Is there some broad application that
20 might be constructed in the next few days? Or are you
21 looking at --

22 Mr. Schieber. We have had no discussions beyond very
23 casual ones, and I can't answer that. We certainly could
24 try. I had suggested before that I am as concerned with
25 the problem of excessive personal use with respect to

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1 company-owned assets as I am the value of an asset. My guess
2 is that you will eliminate the \$106,000.00 BMW if you make
3 sure that if that car is driven home for personal use 70
4 percent of the time that the depreciation deduction is
5 appropriately eliminated, and I think that problem is as
6 serious a problem as the extravagance problem. And if the
7 committee is of a mind to deal in this area, I think it
8 would be equally as important to try to deal with what,
9 admittedly, is a very difficult subject, and that is trying
10 to put some teeth in the statute and give the Revenue
11 Service some greater ability to deal with the difficult
12 subject of personal use of company-owned assets.

13 But we would certainly be happy to try to work with
14 the staff and with the members who are interested in this
15 and try to come up with something.

16 Senator Chafee. Mr. Chairman, ask is the principal
17 sponsor.

18 The Chairman. I think Max and Pat are.

19 Senator Baucus. Mr. Chairman, I haven't yet heard
20 anybody defend the use of expensing above \$15,000.00 value
21 in a car. I mean, nobody has defended that proposition yet.
22 And I would like to hear somebody defend that. So far,
23 nobody has. The only arguments I have heard thus far are
24 that maybe it is a little complicated, and maybe there are
25 some abuses in some other areas.

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1 And frankly, it seems to me if nobody is going to come
2 forward and defend -- taking the investment tax credit and
3 the ACRS values and, in effect, making a profit on the
4 resale -- if no one is going to defend all that, then let's
5 go forward with taking care of this abuse, and that will
6 encourage us to take care of the other problems that Treasury
7 has mentioned.

8 I just think we should get started here. I think it
9 is clear.

10 Mr. Schieber. Senator, if I understand correctly, the
11 bill contains an exception for companies that are in the
12 business of offering limousine services, presumably --

13 Senator Bradley. So there is a loophole in this
14 loophole phrase.

15 Mr. Schieber. I may be wrong. I stand corrected, but
16 I raised that simply to point out the kinds of things you
17 get into. I am not persuaded that if a corporation owns
18 a \$17,000.00 limousine that -- and let's assume that it is
19 not used at all on a personal basis by any of the
20 executives -- that it is used solely for purposes of
21 transporting people around the city of Washington, and to
22 and from airports, and the like -- that that is an extravagant
23 use, even though the cost is in excess of \$15,000.00.

24 Senator Baucus. Personally, I think it is. It is my
25 personal judgment that if a corporation could afford a

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1 \$40,000.00 or \$50,000.00 car, it should pay for it and not
2 be able to sell it two or three years later and make a profit
3 on it. I just don't think that is what we want to do here.

4 Senator Chafee. Mr. Chairman, I echo that view. We
5 enumerable hours on this thing. Sure, it isn't the complete
6 solution. And yes, the Treasury can come up with tighter
7 rules some time. But here we are. I think we ought to vote
8 on the thing. I think we ought to vote on it and hope we
9 approve it.

10 Senator Bradley. Could I offer a substitute?

11 The Chairman. A substitute would be in order.

12 Senator Bradley. I mean, one could offer a substitute
13 with Lear jets over \$6 million in value and this proposal.

14 The Chairman. Only Lear jets?

15 Senator Bradley. Mr. Chairman, if we have no time to
16 develop a list, we could certainly have a more rational
17 approach.

18 Senator Chafee. This isn't the last day we are going
19 to meet, and if Senator Bradley has got one, bring her in.
20 But meanwhile, let's get on with this. We have had this
21 before us. This is a piece of legislation that has been
22 submitted. I don't know how many co-sponsors Senator
23 Moynihan has got.

24 The Chairman. It would seem to me that this-- There is
25 something that we are going to have to vote on sooner or

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1 later, and this is probably in that category. Why don't I
2 give Treasury at least overnight to try to maybe find some
3 rule of general application. I think you could-- Maybe
4 that is not enough, but then you could ask for an extension.

5 Senator Moynihan. Okay. All right.

6 The Chairman. That would be all right?

7 Senator Moynihan. Sure.

8 The Chairman. I think Senator Bradley raised a good
9 point. I don't know how you --

10 Senator Bradley. I am certainly not going to stand up
11 and defend this.

12 The Chairman. No.

13 Senator Bradley. Other than the fact that it is an
14 arbitrary selection, and I think it would be better if we
15 approached it on a general basis. It might even get more
16 revenue.

17 The Chairman. Does anybody on the committee have any
18 ideas on a general approach?

19 Mr. Wetzler. No, I think you could keep adding lists
20 of items.

21 The Chairman. I think if we had enough on the list, it
22 would help us with some of the other areas we have to address.
23 I think the CEOs might pay attention to this.

24 Senator Boren. Are country club dues and private club
25 dues deductible as business expenses now?

1 They are?

2 Mr. Schieber. Yes, they are if the business use -- I
3 mean, there are documentation requirements, and there indeed
4 are no limits other than the general business expense limit
5 of extravagance -- there is a statutory extravagance
6 standard, but it is very --

7 Senator Baucus. I would like to point out, too, that
8 this is depreciable asset. There probably is a problem
9 with dues, I grant you, but there is an additional problem
10 here that this is an appreciable asset because of the high
11 resale values of these kinds of cars which is a subsidy in
12 itself. With that benefit, you can get more than what you
13 paid for. So, it is worse than the country club dues problem.

14 The same might occur with jets. I think the resale
15 value of jets, too, is very high.

16 Senator Bradley. Well, that only illustrates, I think,
17 the point the Chairman made which is -- maybe there is a
18 general rule approach to this that you would be able to put
19 in some other --

20 Senator Moynihan. Mr. Chairman, we are willing to see
21 what --

22 The Chairman. It may take longer. Maybe some time--
23 I assume you will put staff on it.

24 Mr. Schieber. Yes.

25 The Chairman. Maybe by tomorrow afternoon, we could at

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1 least take a look at some ideas of the Joint Committee and
2 our own committee staff. I think we do have a problem if
3 we just single out one item.

4 Senator Moynihan. Mr. Chairman, we were -- when you
5 were away for a moment -- the panel -- I believe the Joint
6 Committee and the committee staff and the Treasury are
7 willing--are prepared to talk about this alternative minimum
8 tax, which we had. Senator Danforth isn't here -- and I
9 don't know if he is going to be here -- I don't know whether
10 we are going to get a moment to do this.

11 This is the most serious proposal I have for this
12 committee that I have brought in for a long time.

13 The Chairman. Is the Joint Committee prepared to
14 discuss it?

15 Mr. Wetzler. Yes. We worked with Senator Moynihan's
16 staff and I believe the Treasury last night and have a
17 little description of the proposal.

18 The Chairman. Can you hand those out?

19 Senator Moynihan. Can I have a moment if anybody is
20 listening? This staff works all day in this committee, and
21 then they work all night in various rooms around this place.
22 And I don't know if they know that we know this, but we have
23 caught on to it.

24 Mr. Wetzler. What this does is it starts from the
25 present law -- alternative minimum tax -- which starts with

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1 your adjusted gross income, adds in an enumerated list of
2 about a dozen tax preferences, allows certain itemized
3 deductions, then allows an exemption of \$30,000.00 --

4 Senator Bentsen. Excuse me, is that tax expenses?

5 Mr. Wetzler. I am sorry. It allows --

6 Senator Bentsen. Tax preferences? Some of the language
7 I want to be sure I understand.

8 Mr. Wetzler. I am just first describing the present
9 law, Senator Bentsen, because this proposal is an amendment
10 to present law.

11 Senator Bentsen. I am just trying to understand the
12 meaning of the term "tax preference."

13 Mr. Wetzler. There is a list of about a dozen of them
14 in the --

15 Senator Bentsen. Those are expenses, is that correct?

16 Mr. Wetzler. Yes. Most of them are deductions.

17 Senator Moynihan. They are deductions.

18 Mr. Wetzler. The exclusive part of capital gains,
19 percentage depletion --

20 Senator Bentsen. I understand. I just wanted to know
21 like that term "unearned income" -- I want to be sure what
22 it means.

23 Mr. Wetzler. These are called tax preferences in the
24 Code. We didn't think that up.

25 Senator Bentsen. I know, and I know who put it in there.

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1 (Laughter_

2 Mr. Wetzler. That dates back to 1969.

3 Senator Bentsen. Tax expenditures, unearned income.

4 Mr. Wetzler. But you start with adjusted gross income.

5 Add back a number of items. Then deduct certain, but not

6 all, itemized deductions that are allowed under the regular

7 tax. Then you subtract an exemption today of \$30,000.00

8 for a single person, \$40,000.00 for a married couple. Then

9 you compute a tax equal to 20 percent of that tax base and

10 pay that if it exceeds your regular tax.

11 And that minimum tax raises about \$1.5 billion today.

12 What Senator Moynihan's proposal would do is add in two

13 additional tax preferences to the present law list.

14 The first of these would be deductions from limited

15 business interests and rental activities, and these are

16 ones in which the tax -- these are limited partnerships and

17 they are either Subchapter S corporations or rental activities

18 in which the taxpayer does not materially participate.

19 And you add in the deductions from those activities in

20 excess of the income from all such activities.

21 The concept would be you shouldn't have your losses

22 from your limited business interests and your rental

23 activities, in effect, allowable against unrelated incomes,

24 such as earned income or investment income from interest in

25 dividends.

1 Senator Packwood. Let me make sure I understand this.
2 I can only offset the losses against income from a similar
3 investment.

4 Mr. Wetzler. Right.

5 Senator Packwood. If I choose to have two investments
6 of two different kinds, I cannot offset the losses of one
7 against the income of another.

8 Mr. Wetzler. If, for example, you were a limited partner
9 in two partnerships, you could offset the losses from one
10 of those limited partnerships against the income from the
11 other limited partnership.

12 Senator Packwood. No matter what business they were
13 involved in?

14 Mr. Wetzler. Right, but not against your interest or
15 dividend or your wage or salary income. For minimum tax
16 purposes, now. You could treat your regular tax under the
17 ordinary rule.

18 Senator Packwood. And this is not akin -- I am trying
19 to remember back when it was that Bill Simond was proposing
20 in the last days when he was Treasury Secretary and had
21 three initials --

22 Mr. Wetzler. LAL is what it was called.

23 Senator Packwood. Is this the same thing?

24 Mr. Wetzler. Not exactly. The LAL proposal, which the
25 Treasury made back in the Nixon Administration, was, first

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1 of all, a limit on what deductions were allowable under the
2 regular tax. This is only the minimum tax. You are talking
3 at most of a tax at a rate of 20 percent.

4 Senator Packwood. I understand that. Is the theory
5 the same?

6 Mr. Wetzler. The other difference was the LAL said
7 you couldn't use your deductions from one building against
8 income from any other building or any other type of income
9 at all.

10 Senator Packwood. It was limited activity by activity
11 by activity.

12 Mr. Wetzler. Yes. Right.

13 Senator Packwood. Whereas this is limited --

14 Mr. Wetzler. In some cases, building by building by
15 building, or oil well by oil well, back in the House
16 approved LAL proposal back in the 1970s, which the Finance
17 Committee rejected.

18 But this is somewhat milder in the sense that you could
19 allow one partnership against another and all we are talking
20 about here is the minimum tax, not the regular tax. This
21 is really quite a bit milder than the old LAL proposal.

22 Senator Moynihan. I wonder if I could say to Senator
23 Packwood that contrary to what I think we expected when the
24 maximum tax went from 70 to 50, there has been an explosion
25 of tax shelters. And one more-- And they are becoming more

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1 audacious because the ratio has to be higher than it used to
2 be to get a good return. And people are just taking plain
3 tax shelters -- you know, the llama farm and what you will
4 -- and just deducting it against what they would owe under
5 the minimum tax and they are not paying those taxes.

6 Senator Packwood. Pat, I have mixed feelings about this
7 because I think when we are talking -- I don't know how
8 much revenue you are talking about -- what, a couple of
9 billion dollars?

10 Mr. Wetzler. We are still working on the revenue
11 estimate.

12 Senator Packwood. One day this rubber band on tax
13 shelters and industrial development bonds is going to snap,
14 and Congress is going to let loose a fury and lash out in
15 all directions because the public is fed up with paper
16 shuffling, churning tax shelters. But all of-- My hunch
17 is that if we limit them all very severely, I have no idea,
18 but it isn't going to raise us a great deal of money. It
19 ought to be done on the basis of fairness and equity and
20 the public having confidence in the Tax Code, but it also
21 must avoid the ultimate problem of a revenue base that
22 produces a great deal of money.

23 And I think those are two separate problems. They are
24 both legitimate problems.

25 Senator Moynihan. They are two separate problems. I

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1 guess I would make the point that the effort to stop tax
2 shelters one at a time, as Senator Long had so brilliantly
3 pointed out one day -- he asked Larry Woodward how many
4 lawyers he had and how many lawyers there were in the IRS
5 and it came to about 120, and then he asked how many lawyers
6 were there on the other side, and he said about 20,000 or
7 40,000 --

8 Senator Long. It was 500 against 50,000.

9 Senator Moynihan. It was 500 against 50,000, and that
10 was about the odds on stopping the shelters. This takes a
11 different approach. It says don't make the shelters
12 profitable, at least for some people. It is just not that
13 profitable.

14 It is a different strategy, and I think it is a
15 legitimate one. And I would say to Bob, if I can get his
16 attention for a minute, rather like the tax straddle
17 situation we passed about two years ago, what you save
18 today is one thing, but what you prevent yourself from
19 losing in the years to come as this particular practice
20 balloons can be a very different thing indeed.

21 The Chairman. Has Treasury had a chance to review this
22 proposal?

23 Mr. Schieber. We are in the process of doing that. We
24 met with the staffs last night, and we are continuing our
25 work today. It is a proposal that has obviously broad impact.

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1 It is one that is of interest to us. We hope to continue
2 that study. We are not in a position at this point to
3 indicate our --

4 The Chairman. When will you have revenue estimates?
5 By tomorrow?

6 Mr. Schieber. I hope we do by tomorrow, yes.

7 The Chairman. Again, I would suggest that we -- there
8 are more members here today and at least they are aware of
9 it. We have some description. Perhaps it is another matter
10 we are going to have to defer until tomorrow.

11 Senator Long. Now, Mr. Chairman, this is an interesting
12 proposal and I think it certainly deserves the attention of
13 the committee. But if we are going to vote on it, we really
14 ought to see what it looks like put up there on that board
15 where everybody on the committee and everybody in the room
16 can see what we are talking about. And we really ought to
17 have a lot of examples to look at so you can see how it
18 would tend to work out.

19 Down through the years, I have favored the minimum tax,
20 and I thought we had a pretty good minimum tax. Let me
21 ask Mr. Hardee. Can you give me your indication or some
22 indication as to what you know about this matter?

23 Mr. Hardee. In the TEFRA, we put in a very substantial
24 minimum tax, and I think this would see --

25 Senator Long. 20 percent, isn't it?

1 Mr. Hardee. 20 percent. We work off that same base,
2 adding in Senator Moynihan's proposal -- to add in a couple
3 of more preference items, and allowing the same deductions
4 that we basically allow with the minimum tax. So, it is
5 working off the minimum tax base that we put into place in
6 TEFRA.

7 Senator Long. Now, I personally feel that the 20
8 percent tax on what a person's economic income is is a fair
9 tax. If they make that much economic income, that is fair.
10 But I do think that we need to understand it because I have
11 no doubt that we will find some irate taxpayers out there
12 who we are going to get the first time because they didn't
13 know about it, and they will claim that we didn't give them
14 their day in court.

15 So, I do think that we ought to try to make it available
16 to as many people as possible to look at and also how it
17 would work because in fairness I think people have a right
18 to come forward and see some of this.

19 Frankly, to me, it is almost foolish some things we put
20 into law. I recall when Paul -- had an amendment to try
21 to help some people who wanted to save the small family
22 farm, I think we wanted to tax the eyeballs out of somebody.
23 I can't recall how we did it. They had no idea. Nobody saw
24 it coming. I think the Chairman of the House Ways and Means
25 Committee said if we are going to take this, they insisted

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1 on some of their own ideas, and by the time they got through,
2 you saw what happened to it.

3 We definitely ought to understand it, and I would hope
4 that the public would understand what it is. If it is going
5 to be a big item -- it sounds like a big item -- and it may
6 be something I could support. We ought to know it. We ought
7 to understand it, and also the public has to get to know
8 about it.

9 The Chairman. Senator Bentsen.

10 Senator Bentsen. I certainly agree with Senator Long
11 on that one. I supported the amendment tax, and one thing
12 you can't have happen is people making great amounts of
13 income and then not pay any taxes. You destroy the confidence
14 in the tax system. The only thing you must be careful of
15 is to be sure that they do have that true economic income
16 and that you have not blurred it with something else when
17 the person actually has a loss.

18 So, how you draft it, how you draw it is terribly
19 important, and as Senator Long says, we should have full
20 notice of it and knowledge of it so we can understand
21 definitely how it is going to work.

22 Senator Long. What items does this add to the tax
23 preference list?

24 Mr. Wetzler. This doesn't add anything specific to
25 the list. This just deals with general losses in certain

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1 areas. For example, oil and gas -- already you have got
2 intangible drilling costs that are in there now -- so this
3 probably wouldn't have very much impact, at least with
4 respect to the intangibles that are in there now -- but
5 there are a lot of other more exotic businesses that have
6 not, you know -- where we have not specifically enumerated
7 preferences, and the idea there--

8 I guess the analogy you would want to draw is with the
9 present treatment of capital losses. Today we say that
10 capital losses are deductible against capital gains but only
11 against a limited amount of ordinary income. The idea being
12 that somebody shouldn't be able to use his losses as an
13 inducement to zero out his tax on the rest of his income.

14 You know, to some extent, it is harsh on people who do
15 have real losses. On the other hand, it does protect the
16 tax base from people who can sort of selectively realize
17 their losses and not their gains. And that is the same
18 theory here -- that there should be some cordoning off of
19 your limited partnerships, your Subchapter S corporations,
20 your rental activities -- there should be some cordoning
21 off of the losses you are able to generate there against
22 your interest and dividend and wage and salary, at least
23 for purposes of the minimum tax.

24 And that is the theory of the proposal.

25 Senator Moynihan. Can I speak to that? I won't continue

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1 it because I think the Chairman wants to move on. I would
2 say to Senator Long that the purposes of the minimum tax
3 are being defeated now by a sudden explosion of plain
4 tax-sheltering operations which allow you to accumulate
5 greater losses in this year which you can deduct from the
6 earned income and investment income, and so then suddenly
7 you don't pay the minimum tax.

8 And it won't change any oil or gas -- all those things
9 are already listed. It just says these new gimmicks that
10 are coming on the market because of this, and it doesn't
11 try to stop them one by one -- it stops them at the other
12 end so you can't deduct them. That is all.

13 The Chairman. Okay, then, let's do that. Let's give
14 Treasury more of an opportunity and maybe get some revenue
15 estimates and get some examples, and we will have Jim work
16 it out on the blackboard a couple of times tomorrow.

17 Mr. Wetzler. We will think up some examples.

18 The Chairman. Pardon?

19 Mr. Wetzler. We will think up some examples. Now, one
20 you may want to go to. We have now an estimate on the
21 electronics phones transfer. There, what we were suggesting
22 as a compromise was the original proposal would have
23 basically eliminated all the float and what this does is
24 give the industries a uniform 14 days of float, and that
25 would raise \$700 million over the four-year period, 1984

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1 through 1987.

2 The Chairman. As opposed to what?

3 Mr. Wetzler. The earlier estimate was-- It raises
4 essentially the same amount as the original proposal, but
5 because, you know, your September 15th period -- you are
6 still collecting it on September 29th -- you still raise
7 the money in the fiscal year. So, in terms of budget
8 accounting, the additional 14 days we are suggesting doesn't
9 really cost us any money off the original proposal, which
10 as reestimated is now \$700 million.

11 The Chairman. I assume that would respond to the
12 question raised by Senator Tribble.

13 Mr. DeArment. I think that this addresses the most
14 pressing of his concerns.

15 The Chairman. And also Senator Huddleston mentioned
16 to me --

17 Mr. DeArment. And Senator Helms has also raised this
18 issue.

19 The Chairman. If there are no objections, why don't
20 we take that compromise? It does make some difference and
21 we can have tentative approval of that.

22 And then there are a couple of freeze items that I
23 don't see any problem with. If we limit the ITC on used
24 properties to \$125,000.00 and limit the 911 excluded income
25 to \$80,000.00, we discussed those items earlier -- and they

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1 save about \$200 million apiece, each over three years. Is
2 that correct?

3 Mr. DeArment. That is correct. There are about \$200
4 million for each proposal.

5 The Chairman. Unless there is objection, we will adopt
6 those two items. And then I think there is a couple of
7 billion in the Grace Commission recommendations that maybe
8 we can agree to.

9 Mr. DeArment. Yes. Maybe we can explain those
10 recommendations beyond the ones we discussed this morning.

11 (Pause)

12 (continued on next page)

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1 The Chairman. All right, Rod, do you want to give us the
2 Grace Commission -- we are going to have a roll call I am
3 advised in a few minutes, so is there something we can do?

4 Mr. Dorsey. Yes. You should have before you a
5 description of Grace Commission options, dated February 29th.

6 The Chairman. February 29th?

7 Mr. Dorsey. That's right. And also a chart of CBO
8 estimates of the proposals.

9 Mr. DeArment. These CBO estimates are the ones that we
10 had this morning. They are re-examining some of these
11 estimates, and we can only go up.

12 Senator Long. Can you tell me how much money we are
13 raising with the minimum tax right now?

14 Mr. Wetzler. Today we are raising about a billion and
15 a half dollars a year, roughly speaking.

16 Senator Long. Only a billion and a half dollars?

17 Mr. Wetzler. Approximately. It is somewhat hard to
18 say because one of the planning techniques that people use to
19 get around the minimum tax is to slow down their deductions
20 or to accelerate their income under the regular tax. So we
21 don't really pick them up in the minimum tax statistics. So
22 it might be more than that. But it is at least that much.

23 Senator Long. Can you give us a guess as to how much
24 the Moynihan amendment might raise?

25 Mr. Wetzler. Well, I would say it would be roughly a

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1 billion dollars a year, so it would be a significant item.

2 Senator Moynihan. It is not the billion dollars. It is
3 the \$6 billion next year you would lose.

4 The Chairman. All right. Stu, are you ready?

5 Do I understand this chart, these are not the latest
6 figures?

7 Mr. Dorsey. Those are not the latest, yes. We hope to
8 get some of those perhaps maybe a little higher, and we may
9 have some other things to add to the list which may produce
10 some additional savings. I think that is the minimum amount
11 that we have established.

12 The Chairman. All right.

13 To offset the general debt owed to the government, we
14 have already got Treasury looking at that.

15 Mr. DeArment. That is right.

16 The Chairman. What about the second one?

17 Mr. Dorsey. The second is a proposal to mail payroll
18 checks to federal employees on the due date rather than
19 before.

20 Currently, federal employees have the choice of picking
21 up their check in person, receiving it by mail or by the
22 electronics funds transfer direct deposit. This proposal
23 would require the Treasury to mail the checks on the due date
24 rather than before the due date, and that would encourage
25 the transfer to an electronics funds transfer system. And

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1 savings are estimated because you would slip back three days.

2 The Chairman. Do we have jurisdiction of that?

3 Mr. Dorsey. Yes, I believe we do.

4 The Chairman. What, all checks, or social security
5 checks, or --

6 Mr. DeArment. This is just payroll checks here.

7 Mr. Dorsey. Right. The proposal before you is just
8 payroll checks. But there are also additional savings that
9 could be generated of about \$1.3 billion by doing the same
10 for all checks. The Treasury issues the benefit checks as
11 well as payroll checks.

12 Mr. DeArment. Supervising the Treasury's payments.

13 The Chairman. Oh, I see.

14 Mr. Dorsey. Yes.

15 The Chairman. Does Treasury have a view on this?

16 Mr. Schieber. Yes. Mr. Chairman, we are supportive of
17 this EFP transfer. We have asked OMB to review it and make
18 sure that they are on board, and we are waiting for their
19 response. But I would expect, subject to that, we will have
20 no problem.

21 The Chairman. You have discussed it with OMB, haven't
22 you? We don't want to get into somebody else's jurisdiction
23 here.

24 Mr. Dorsey. Yes.

25 The Chairman. We could use the savings though.

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1 Mr. Dorsey. Right.

2 And the savings that are before you on the chart are
3 just for the payroll checks. We could establish additional
4 savings by extending this proposal to benefit checks as well.

5 The Chairman. Would somebody suffer from this? I mean,
6 the checks arrive later. Is that it?

7 Mr. Dorsey. The checks would arrive three days later.
8 That's the assumption, yes.

9 Mr. DeArment. But they can have them directly deposited
10 in the bank on the same day that they now receive the check.

11 The Chairman. Through the electronic funds transfer?

12 Mr. Dorsey. That is correct.

13 The Chairman. Can that be done in every instance?

14 Mr. Dorsey. Yes.

15 Mr. DeArment. No. If you don't have a bank account.
16 You have to have a bank account.

17 The Chairman. You would have to have an account, right.

18 Mr. DeArment. Yes.

19 Senator Long. What does EFT mean here?

20 Mr. Dorsey. Electronic funds transfer, the direct
21 deposit of the checks.

22 The Chairman. So there is a chance that we could save
23 a billion?

24 Mr. Dorsey. About another \$1.3 billion, yes. If you
25 extended it to benefit payments, okay. The numbers that you

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1 have before you are just federal employee paychecks.

2 Senator Grassley. I would question the benefits though.
3 They all come in one year, according to this. And I will bet
4 that with that \$1.3 billion it is the same way. It all comes
5 in the first year.

6 Mr. Dorsey. That is correct, Senator. It is front
7 loaded to that first year. And then any additional savings
8 are interest savings and a small amount of administrative
9 savings.

10 The Chairman. Sort of administrative savings, isn't it?

11 Mr. Dorsey. A very small amount. Most of it is just
12 the slippage of a 3-day delay.

13 Senator Grassley. So what we are talking about
14 accomplishing here is saving this \$1 million each year into
15 the future.

16 The Chairman. One time.

17 Mr. Dorsey. It is a one time saving, right.

18 Senator Grassley. There is a continued savings of
19 \$1 million.

20 The Chairman. Is it mostly smoke?

21 Mr. Dorsey. It is a real budget savings.

22 The Chairman. Well, that could be smoke too.

23 Mr. Dorsey. Yes, that's right.

24 The Chairman. The way the Budget Committee plays around.

25 Mr. Dorsey. It is shifting money from one year into

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1 another.

2 The Chairman. Well, we ought to do the same thing that
3 that committee does.

4 How does the Joint Committee look at this? Carefully?

5 Mr. Wetzler. No. This isn't really a tax item.

6 The Chairman. All right.

7 Mr. Wetzler. You get the savings, of course, because
8 in September, instead of the pay checks being received in the
9 end of September, it is mailed at the end of September. The
10 person doesn't cash it until October.

11 The Chairman. You mean October.

12 Mr. Wetzler. And so the money slots over into the
13 next fiscal year. It is a cash management device similar to
14 many of the ones that we have done in the past.

15 Senator Grassley. We have a Constitutional requirement
16 requiring a balanced budget. We might need it in the future
17 sometime.

18 The Chairman. You don't think we need it now?

19 Senator Grassley. Not as much as we are going to need
20 it if we ever have that.

21 (Laughter)

22 Senator Bradley. Is that what you say in speeches?

23 The Chairman. Well, let's let Treasury look at this
24 overnight, if they let them work overnight.

25 What about number 3, eliminate policy research within

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1 HHS? Department management. I don't know what that is.

2 Mr. Dorsey. All right.

3 Currently, most of the research that HHS does is
4 within its four operating divisions, within SSA, within HCFA,
5 Public Health Service. There is, however, a small research
6 group within the Secretary's office, with Department
7 Management, that conducts research.

8 The Grace Commission recommendation was to eliminate
9 this office on the grounds that the research that was being
10 conducted was redundant to what was being done within the
11 operating divisions, and that they really didn't have the
12 resources to do a very good job anyway. And so this proposal
13 would be to eliminate that policy research within HHS
14 Department Management.

15 The Chairman. Is HHS supportive?

16 Mr. Sermier. No, Mr. Chairman.

17 I am Robert Sermier from the Office of the Secretary. We
18 support a reduction, and the FY 85 budget calls for \$8 million
19 as opposed to the \$14.7 million that this is based. This is
20 the Secretary's discretionary research account. There are
21 several very important research projects, in our view, that
22 are supported through this account. We agree with a
23 reduction but not with an elimination.

24 The Chairman. Pat, do you want to speak on that?

25 Senator Moynihan. Mr. Chairman, I was once an assistant

1 secretary of Labor for policy, planning and research, and we
2 had a large department with big research and development
3 activities going on in other places. Ours was a very small
4 office. But absent just a little money that that assistant
5 secretary can put out here and put out there, we might as
6 well not have an assistant secretary.

7 These are very small sums, \$8 million, as compared to
8 \$4 billion.

9 Mr. Dorsey. Yes, sir.

10 Senator Moynihan. And it is the way you sometimes do
11 things that surprise you.

12 The Chairman. All right. Let's pass this one.

13 Senator Grassley. Well, following Senator Moynihan's
14 suggestion, how much would we save if we eliminated the
15 assistant secretary?

16 (Laughter)

17 Senator Moynihan. Well, you would save about a
18 hundred thousand dollars a year. And remember, she is a
19 Republican.

20 (Laughter)

21 The Chairman. I think there is a vacancy.

22 Let's go on to a little more bigger fish here. Let's
23 don't break up over 14 million. We are going to need about
24 \$22 billion. Either that or we don't have any add-ons. So if
25 you don't want any add-ons, why we would do that structure

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1 thing tomorrow and wrap it up.

2 Mr. Dorsey. And the fourth option is a combined welfare
3 administration proposal. And this is a Grace Commission
4 proposal similiar to an earlier Administration proposal to
5 substitute a single payment to states for the cost of
6 administering the Medicaid, AFDC and the food stamp programs.
7 And the funding levels would be based upon estimated caseloads
8 and reflect current cost levels, combine welfare
9 administration.

10 The Chairman. Does the Administration have a position?
11 It is not a requirement.

12 Mr. Sabatini. No, we don't have a position on it.

13 The Chairman. Pardon.

14 Mr. Sabatini. No, we don't have a position. This is
15 similar to a provision that the Administration had submitted
16 sometime ago. The problem with this recommendation is that
17 it is really just a movement of cost from the federal
18 government and shifting it to the States, and it does not
19 accomplish a great deal.

20 The Chairman. It would accomplish a lot for the
21 federal government.

22 Mr. Sabatini. For the federal government, but it would
23 just be moving costs over.

24 The Chairman. But the governors just left town. They
25 are all saying we ought to reduce the deficit. They put out

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1 a big statement.

2 Senator Long. Would this require the States to combine
3 their welfare administration or the federal government?

4 Mr. Sabatini. What it does is it simply says that all
5 the money for the administration of these various programs
6 would be combined into a single grant for granting it to the
7 States. And it would be capped at whatever level you would
8 decide to cap it. I think the Grace Commission recommended
9 it be capped at the 1983 levels.

10 Senator Baucus. Mr. Chairman, I am advised by my staff
11 that this was not to be on this list. And I am just now
12 advised that this tends to, at least with respect to Medicaid,
13 hurt rural states disproportionately compared to other states.

14 Now the list I have has New York State, Texas and
15 Montana. Down below, that is, the states are going to be
16 hurt more than other states. Now that might be fine. I
17 don't know. But the point is that we haven't looked into
18 this because we were told this was not to be on this list.
19 So I just wonder if we could have sometime maybe to pass it
20 over and look at it.

21 The Chairman. Yes. Let's pass it over. Can we agree
22 on anything here? I mean, is there approved verification?
23 That ought to be a winner.

24 Mr. Dorsey. Yes. Improved income verification. This
25 proposal is to make additional income and asset data available

1 to the AFDC, SSI, food stamp, Medicaid, and Section 8 housing
2 program for verification of eligibility.

3 Now this would require some legislation to require all
4 States to collect quarterly wage data. It would require
5 legislation to amend the Tax Reform Act of 1976 to permit the
6 disclosure of IRS data on unearned income, and to permit
7 disclosure of SSA wage data.

8 The other proposals are in the nature of administrative
9 recommendations to coordinate the use of this data and
10 develop sort of a master plan for matching this data. And
11 the goal is to reduce the overpayments in these programs.

12 The Chairman. A number of those programs you mentioned
13 we don't have jurisdiction of. The only one we have on
14 Medicaid, what, SSI?

15 Mr. Dorsey. AFDC, SSI and Medicaid, yes.

16 The Chairman. Does the Administration have somebody
17 to speak to this?

18 Mr. Sermier. Mr. Chairman, we do not have a position,
19 because it cuts across all Departments' understudy. And we
20 don't even have estimates of the possible savings.

21 There is no question that we support efforts to improve
22 verification. But there will be front end costs. This
23 envisions much, much greater use of computer systems, much,
24 much greater interchanges of data files. It will take some
25 time to set up. There is no question we would support it in

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1 theory, but whether we can support this particular proposal,
2 we will have to await the completion of our analysis.

3 Senator Moynihan. Mr. Chairman, with the greatest
4 respect, who it is that told the Grace Commission that in
5 fiscal 1987 this program would save \$405 million, a few
6 million, 714?

7 Now we know enough about government. No, you don't know
8 what is taking place.

9 Mr. Dorsey. Senator Moynihan, these are not Grace
10 Commission estimates you have before you. This was a CBO
11 estimate.

12 Senator Moynihan. Was that the CBO?

13 Mr. Dorsey. Yes, sir.

14 Senator Long. Tell me how you are supposed to improve
15 income verification? How do you do that?

16 Mr. Dorsey. The proposal would provide additional data
17 sources for the administrators of the program. It would
18 provide for additional quarterly wage data provided by the
19 States, and it would open up the Social Security
20 Administration files and provide IRS income, data on unearned
21 income. Okay.

22 That would provide the available data. Then it would be
23 up to the Administration to coordinate the use of that data,
24 and to develop a computer matching system so whereby you could
25 check someone's application for one particular program against

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1 the income or assets that they may have reported somewhere
2 else.

3 So it is basically a cross-checking type of proposal.

4 Senator Bradley. You mean that the IRS would send
5 information on essentially, if you are going to have a data
6 base, the whole IRS file had to be available so that if
7 anybody applies for an NEH grant or for a grant for low income
8 energy assistant, or whatever, you would push the button and
9 there would be that person's IRS data?

10 Mr. DeArment. No. What it would be is to the extent that
11 you have one of these income tested programs, there would be
12 data available to the people that do the income testing as
13 to what the IRS information is on outside earnings, for
14 instance.

15 Senator Bradley. You mean the person that does it in
16 whatever the bureacracy is would call over to the IRS and
17 say, Mr. Rod DeArment, now what was his income last year?"

18 Mr. DeArment. Yes, that is essentially what this
19 involves.

20 Mr. Sterling. Senator, under current law, HHS can get
21 from the IRS your earned income information. What they can
22 not get is your passive income information, i.e., your
23 interest and dividend income. And this would basically allow
24 HHS to also access that in order to determine eligibility.

25 Senator Bradley. So that under current law they can get

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1 your wage income?

2 Mr. Sterling. Yes, sir.

3 Senator Bradley. Well, I don't see any reason why not.

4 Senator Moynihan. Those people have a lot of interest
5 in investment income.

6 Mr. DeArment. This is something that the GAO has
7 supported. And their comment is that it has considerable
8 merit. And they would make two tightenings. First, they
9 would want to make sure--and this is really not one of our
10 programs that we would want to deal with--but for Section 8
11 housing, they would not make it as a condition of
12 eligibility that you actually produce your income tax return.
13 And they would target the verification procedures in means
14 tested programs.

15 They would extend those to social insurance and other
16 federal retirement programs. In other words, they would
17 broaden the application of it beyond just means tested
18 programs in that respect.

19 The Chairman. Well I wonder if we might agree on number
20 2, the concept, to mail payroll checks on due date and
21 encourage EFT? I understand Treasury has no objection to
22 that.

23 Mr. Schieber. Mr. Chairman, I would just ask that we get
24 the opportunity to make sure that OMB has no objection. We
25 have asked for their views and we should be able to get that

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1 today.

2 The Chairman. I would like to expand that to include --

3 Mr. DeArment. Benefit checks that would be significant.

4 The Chairman. Right.

5 And I recognize that is probably a one-shot budget
6 savings, but at the same time it would be helpful on our
7 case.

8 On these others, I think -- Treasury is also checking on
9 number 1 -- number 4 and 5, I think we do need additional
10 information on number 4 to make certain of the concerns of
11 all States, whether they are rural or urban States, have
12 been addressed. I would hope we might have that information
13 by tomorrow; the same with income verification. I just
14 haven't seen the outline.

15 I think some of these we should vote on and see whether
16 we want to make savings or not. Adopt them. Not now. Wait
17 until we get the additional information that Senator Baucus
18 requested.

19 Is there anything else that we can do right now?

20 Senator Baucus. Mr. Chairman, this is on the Grace
21 Commission.

22 Senator Danforth. No.

23 Senator Baucus. All right.

24 Yesterday I thought the staff, with respect to the
25 Grace Commission recommendations, were going to look at the

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1 proposal I mentioned yesterday dealing with the updating an
2 1896 statute that is requiring government agencies to deposit
3 their federal funds they receive within three days rather
4 than 30 days. The 1896 statute says 30 days. It hasn't been
5 amended since 1896. And there is a bill over in the House--
6 it is the Gilman bill--that would update that in three days.
7 And I wonder if the staff has had a chance to look at that.

8 Mr. DeArment. We have looked at it. Treasury was going
9 to study it.

10 Mr. Schieber. Yes. I'm sorry. We saw it for the first
11 time yesterday and, hopefully, someone has looked at it. I
12 have not.

13 Senator Baucus. Somebody said it saves \$41 million. It
14 is not a lot, but it is something.

15 The Chairman. Mr. Penner mentioned to me this morning
16 in our conversation a speed up of collections at local levels.

17 Mr. DeArment. That is another Grace Commission proposal,
18 the speed up of state and local deposit of social security
19 taxes.

20 The Chairman. I know the States and local communities
21 would like to have that to put it in the bank and make
22 interest on it.

23 Senator Moynihan. We speeded it up in the Social Security
24 Act.

25 The Chairman. Right.

1 Mr. DeArment. We speeded it up in the Social Security
2 Act, and we had one other speed up in the last four or five
3 years.

4 The Chairman. About five years ago.

5 Senator Baucus. The last estimate I heard is that it is
6 \$140 billion the first year, and then it is \$41 the next year.

7 The Chairman. Can we check on the so-called Gilman --

8 Mr. Schieber. Gilman, yes.

9 Senator Baucus. Senator Roth is also interested in it
10 too.

11 The Chairman. Senator Roth.

12 Senator Danforth?

13 Senator Danforth. Mr. Chairman, I have some ideas for
14 raising revenue, and I would like the Finance Committee staff
15 and the Joint Committee, or Treasury, whoever wants to look
16 at it, to look at them in the next day or so, because I will,
17 along with everybody else, have some add-ons to suggest to
18 the bill. But I think that it is only reasonable to give
19 some suggestions for raising revenue.

20 Senator Moynihan has already mentioned the alternative
21 minimum tax, and we have been working on a parallel, and I
22 get the same track now with respect to the alternative
23 minimum tax.

24 The other ideas, just to give notice to the Committee,
25 are as follows. Stock for debt exchanges by corporation; net

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1 operating loss carryovers; and G reorganizations; restrictions
2 on voluntary employee benefit association, or VEBAs; the use
3 of junior stock for employee stock options; and a suggested
4 repeal of Section 125 relating to so-called cafeteria plans
5 for employees.

6 So those are the suggestions. And if the staff could
7 take a look at them, maybe we could bring them up.

8 Mr. Wetzler. We would be happy to do that, Senator.

9 The Chairman. The staff may be aware of some of these.
10 So I think the question of seeing what the interest is.

11 Mr. Belas. We have been reviewing most of those
12 proposals for Senator Danforth already, along with the Joint
13 Committee staff and Treasury, in particular, the voluntary
14 employee benefit association proposal that Senator Danforth
15 has suggested to us.

16 The Chairman. Roscoe, do you have anything to add or
17 subtract? We don't want to subtract anything, but do you have
18 anything to add?

19 Commissioner Eggar. I don't know what you are talking
20 about, having just walked into the room.

21 The Chairman. Anything. We are trying to find \$20
22 billion more.

23 Commissioner Eggar. I doubt if I would be able to add
24 a lot of wisdom to that because I don't know anything about
25 it.

1 The Chairman. I think there was a couple of areas that
2 you may be concerned about, and one is the offset. We don't
3 understand why you can't do that.

4 Mr. Eggar. Yes. Now you are on a subject that I do
5 have some definite ideas about.

6 On the offset, we did a study last year from the accounts
7 that we collected the year before in the child care offset,
8 and we pursued those. And we found that those accounts where
9 we actually do carry out an offset are about twice as likely
10 to come up the next year with a balance due or fail to file.

11 After that happens, then we have got to use up the
12 resources to go out and pursue the return, or even after we
13 get it, we have got a collection problem.

14 We are continuing to do that study this year. But on the
15 basis of the last year's study, the Administration took the
16 position which had been changed from the way they felt before,
17 that we should definitely not expand the offset at this time
18 until we know much more about how it is going to affect the
19 whole system, because we think the potential for future
20 damage to the integrity of the system is just too great.
21 That is the short story.

22 The Chairman. We were talking about tax refunds being
23 used to offset debts that people owed the government. We
24 could take their refund to apply it on the debt. And IRS
25 raised an objection of that. It is one of these Grace

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1 Commission recommendations; I think also GAO.

2 MR. DeArment. GAO has recommended this for years.

3 Senator Grassley. Haven't you just completed a study on
4 this? We brought it up when we were talking about --

5 Commissioner Eggar. Right. Yes. We just finished the
6 study of the second year, but we haven't --

7 Senator Grassley. -- child support. But it isn't made
8 public yet?

9 Commissioner Eggar. No. That was a study which we did
10 internally. But I think we have transmitted some of the
11 information, that is, the relevant data to your office,
12 Senator Grassley. I am not sure whether you have seen it,
13 but I think we have sent it over to your office.

14 Senator Grassley. All right.

15 But the point is to see if it had a negative impact upon
16 whether or not people were going to voluntarily comply.

17 Commissioner Eggar. Two problems. One is that where it
18 happens to them the first time, then a very high percentage
19 of them fail to file a return the next year.

20 Where they do go ahead and file a return, the percentage
21 of balance due as against refund return goes way up. And
22 then, finally, the resources we have to use to track these
23 down and to make the collection, and so on, they lost
24 opportunity cost. And the thing significantly offset any
25 real benefits.

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1 Senator Grassley. All right.

2 Well then it has just been put out because we didn't
3 have the information when we were considering this other
4 legislation.

5 Commissioner Eggar. That is correct; you did not.

6 The Chairman. I think you might also address it. You
7 know, maybe that is not a good idea, but I think Senator Long
8 raised a more general question of how do we increase the
9 audits? How do we get more compliance? What is it, about
10 1.7 percent now that returns are audited?

11 Commissioner Eggar. Well it is less than that. It is
12 about 1.5.

13 Senator Long. Can you tell me how the expense of these
14 audits compares with the returns you are getting in? Now
15 obviously you have got to do the computer match up and all
16 that anyway.

17 Commissioner Eggar. Yes, sir.

18 Senator Long. But I mean just the cost of once you have
19 selected it computer by computer that you are going after,
20 that type of thing, how much is the yield, how is the yield
21 compared to the expense of that 1.5 that you audited?

22 Commissioner Eggar. Our yield on examinations currently,
23 Senator Long, is about \$12.00 to \$1.00. In other words, it
24 is about \$12.00 of revenues for every \$1.00 we spend in the
25 examination activity.

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1 Senator Long. All right.

2 Now that being the case, it just seems to me that if we
3 did more auditing we would collect a lot more money.

4 Now in terms of dollars, how much are you spending on
5 that?

6 Commissioner Eggar. Excuse me. Let me just look here.

7 Okay. The cost on examination is about one to 1.5 billion
8 a year, and our returns on that is about 12 to 13 billion.

9 Senator Long. 12 to 13 billion?

10 Commissioner Eggar. Right.

11 Senator Long. All right.

12 Now it would seem to me that you might be able to double
13 that by just having more people doing that. We have tried to
14 get you more IRS agents, and that just seems to go down the
15 drain because people on one side or the other vote against
16 the item in there to hire more IRS agents. But my thought is
17 why don't we hire some on a contingency basis, just retain
18 some lawyers out there--lawyers, accountants--on a contingency
19 basis to go out there and take some of these attorneys and
20 see what they can do?

21 Senator Moynihan. Can I ask the Commissioner a question?

22 Senator Long. Certainly.

23 Senator Moynihan. Commissioner, are the 1.5 percent
24 audits you make now, are they random, or is part of them
25 random and the others kicked out of the machine?

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1 Commissioner Eggar. No, sir. Those audits are very
2 carefully structured. We have an elaborate system for the
3 selection of returns for examination. We audit a much higher
4 percentage of the more complex returns, a very high percentage
5 of tax shelter returns, a very high percentage of major
6 corporate returns. So that the 1.5 percent is not a random.
7 It is unfortunate. It tends to be misleading because it is
8 a broad percentage.

9 But I think it would be interesting to tell you that the
10 thrust here in the last three years has been to take a look
11 at the whole system. And I think the record shows that we
12 have done it very well.

13 We recently did a study to show ourselves what we have
14 accomplished since 1980, and beginning with 1980 and using
15 constant 1983 dollars, we spent about \$2.8 billion in the
16 whole tax administration system in fiscal year 1980. And we
17 collected in fixed 1983 dollars about slightly over \$15
18 billion.

19 Our projections for 1985 are that we will spend \$3.5
20 billion, which is an increase of about \$700 million. But we
21 expect to put in the Treasury \$33.8 billion, or more than
22 double the amount of revenues collected with very little more
23 expenditure. And the reason we have been able to do that is
24 because of the use of technology and the more efficient
25 approach to the allocation of resources, and so on.

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1 Senator Long. Well, now, my thought is why don't we at
2 least try, on an experimental basis, to see what the potential
3 is just to employing some people in private life, and employ
4 some tax lawyers on a contingency basis and see what they
5 can collect for us?

6 Commissioner Eggar. Well, Senator Long, to begin with,
7 that raises a whole host of ghosts from the past about
8 disclosure of return information for those outside the system
9 that we cannot control.

10 Historically, if you go back in history and look at what
11 has happened to tax systems where you farmed it out on a
12 percentage basis, almost invariable the thing is fought with
13 all kinds of fraud and malfeasance and everything else.

14 I would really hate to be a party to that kind of an
15 approach to a tax administration.

16 The Chairman. We have a vote in progress, and it is my
17 hope that--I don't see any reason to come back this afternoon.
18 The staff needs some time to put together what we have--but
19 we are getting fairly close. We still need to find some
20 additional revenues.

21 There are some of these, the Health Care cap, and others,
22 that we have not addressed. There are the charitable
23 contributions. There is some hope that the Treasury and
24 those who have an interest in that might work out some
25 agreement.

1 But, hopefully, tomorrow we could finish what we could on
2 this spending and revenues, and then move in to the add-ons.
3 That is going to take at least a day or two next week. We
4 will not meet on Friday. So we may need to meet the entire
5 day tomorrow.

6 And maybe the first thing we ought to focus on is the
7 insurance package, so we be getting prepared for that,
8 because that, in itself, will eliminate much of the work and
9 much of the crowd, so others could be seated.

10 Mr. DeArment. Mr. Chairman, we approved a package of
11 additional corporate reform proposals, but we reserved item
12 6 out there to allow Senator Armstrong's staff to examine it.
13 They have examined it and found it was a good idea.

14 The Chairman. That is one of the technical changes.

15 Mr. DeArment. That is correct.

16 The Chairman. Mr. Wetzler okayed it without objection.

17 Mr. DeArment. Yes.

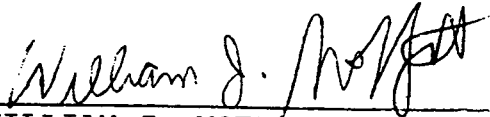
18 The Chairman. And we will stand in recess until 10:00
19 o'clock tomorrow morning.

20 We may ask Commissioner Eggar to come back sometime
21 tomorrow.

22 (Whereupon, at 4:07 p.m., the session was recessed, to
23 reconvene at 10:00 a.m., on Thursday, March 1, 1984.)
24
25

C E R T I F I C A T E

1
2 This is to certify that the foregoing proceedings of an
3 Executive Session on the Deficit Reduction, held on Wednesday,
4 February 29, 1984, were transcribed as herein appears and
5 that this is the original transcript thereof.
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10 
11 WILLIAM J. MOFFITT
12 Official Reporter

13
14 My Commission expires April 14, 1984.
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