

H-0207

MIKE W.

1 EXECUTIVE COMMITTEE MARK-UP SESSION ON DEFICIT REDUCTION
 2 PROPOSALS
 3 TUESDAY, MARCH 13, 1984
 4 U.S. Senate
 5 Committee on Finance
 6 Washington, D.C.

7 The committee met, pursuant to notice, at 10:43 a.m. in
 8 room SD-215, Dirksen Senate Office Building, Senator Robert
 9 J. Dole (chairman) presiding.

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

14 Also present: John Chapoton, Assistant Secretary for
 15 Tax Policy, and Ronald Pearlman, Assistant Secretary for Tax
 16 Policy, Treasury Department.

17 Also present: Roderick DeArment, Esquire; Michael Stern,
 18 Esquire; Richard Belas, Esquire; Donald Suswein, Esquire;
 19 Clint Stretch, Esquire; David Hardee, Esquire; Ann Moran;
 20 Carolyn Weaver; David Brockway; and James Wetzler.

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1 The Chairman. As I understand, the 13 items on the
2 agenda today, for the most part I wouldn't say they are not
3 controversial, but at least we are either prepared to accept
4 them or vote on them, and Treasury has been working on some
5 of these items with different Members who had a problem.

6 You know, we have discussed each one of these a number
7 of times, and if Treasury could just indicate your support
8 for the different items, we could just start with income
9 averaging, what it would do, quickly, and --

10 Mr. Chapoton. Yes. With income averaging, the change
11 would go to three years. I think the difference between this
12 version and the earlier version that the committee acted on
13 was, you would use a three-year base period and the
14 resulting broadening of the brackets to reduce the benefits
15 of income averaging.

16 I think some Members had raised the question
17 of whether to make averaging less available, and so I think
18 there were some questions about this.

19 The Chairman. Does Treasury support this proposal?

20 Mr. Chapoton. Yes, we are on board on this change.
21 Yes, sir.

22 The Chairman. All right.

23 What about the percentage depletion? That was a
24 technical correction of Senator Durenberger's. All he wanted
25 were the revenue figures.

1 Mr. Chapoton. That's right. Our baseline estimate on
2 total receipts and I think the Joint Committee's assumes that
3 this technical correction is fixed, and therefore, by making
4 this change, you do not increase the deficit.

5 If you did not make the change, however, you would
6 increase receipts by about \$800 million over this three
7 year period.

8 The Chairman. But the fact is, it was a mistake.

9 Mr. Chapoton. It clearly was a mistake, all the
10 staffs are agreed. And the revenue estimates reflect that
11 fact.

12 Senator Long. Could you just explain that? I have no
13 idea what it does.

14 The Chairman. Number 2.

15 Senator Long. What are you doing with Number 2?

16 Mr. Chapoton. It simply says that in the 1975 Windfall
17 Profits Tax Act there was an attempt to give an additional
18 benefit to secondary and tertiary production, and therefore
19 it was allowed a higher depletion rate while depletion on
20 other oil phased down.

21 The phase-down was completed in 1983. The intent was
22 that all oil for independent producers would have a
23 15-percent depletion rate beginning in 1984. But in fact,
24 the way it is drafted, in 1984 depletion on secondary and
25 tertiary production falls out of no depletion, and that

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1 clearly wasn't intended.

2 Also, it is argued that because of that same quirk, it
3 is not subject to the anti-transfer rule. This technical
4 correction changes both of those, makes it subject to the
5 anti-transfer rule and keeps it at the 15-percent depletion.

6 The Chairman. All right.

7 Number 3 is a question that Senator Bradley raised.
8 Senator Boren has a direct interest in that. My view was,
9 if we can't accept it, we ought to vote on it.

10 Senator Boren; That would be my position, Mr. Chairman,
11 because I think, as we went over last time and Treasury
12 agrees, it was making the revenue estimates that clearly
13 intended to exclude those items that were in the stream to
14 go into the making of gasoline.

15 Mr. Chapoton. That's correct.

16 Senator Boren. And as I understand it, this does not
17 have a financial impact on Superfund, actually.

18 Mr. Chapoton. No. It determines where the burden for
19 paying the tax falls.

20 Senator Boren. Right.

21 Mr. Chapoton. And this would put it in line with the
22 revenue estimates at the time the Superfund legislation was
23 enacted, and the clear assumptions by the committees and the
24 Congress. And we certainly support this.

25 Senator Long. Let me get this straight. If we don't do

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1 what had been suggested by Senator Boren here, the effect of
2 doing that is to impose a backbreaking tax on industry, and
3 a retroactive tax that was never intended by anyone and
4 never put into the estimates by the Treasury.

5 Mr. Chapoton. That is correct, in the estimates by
6 Treasury or by the Congress. That's right.

7 The Chairman.. All right. Let's go ahead and run
8 through these, and maybe we will have enough Members to take
9 action.

10 Mr. Hardee. Senator Dole?

11 The Chairman. Yes?

12 Mr. Hardee. Senator Baucus also has a question on
13 copper, lead, and zinc use in the Superfund, so you may
14 want to keep both of those together.

15 The Chairman. Well, my view was to keep them separate.

16 Mr. Hardee. Or I mean discuss them together, in the
17 context of the same --

18 The Chairman. Right. But vote on them separately.

19 Mr. Hardee. Yes.

20 Mr. DeArment. This rule that we have laid out here,
21 the description also covers a fertilizer problem that really
22 has to do with whether you have an exemption or file for
23 refunds after the fact. That clears that up, too.

24 Mr. Chapoton. The Golden Parachute proposal by
25 Senator Chafee -- we have worked with Senator Chafee on an

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1 approach. He had a penalty tax if a compensation arrangement
2 after or following a takeover by the departing executives,
3 compensation to the parting executives would be subject to
4 penalty taxes both at the individual executive level and
5 at the company level.

6 We have suggested a substitute, if the committee wants
7 to take action in this area. We attempt to define what is
8 a "Golden Parachute," and I think the consensus seems to be
9 some extraordinary compensation for the departing executives
10 following a takeover -- either friendly or unfriendly.

11 The Chairman. I think Senator Symms had a question on
12 that.

13 Senator Symms. Buck, the question I've got is that
14 in my State -- well, I can tell you the names of the
15 companies:-- Heckler Mining Company took over Day Mining
16 Company. And in terms of giant corporations, they are not;
17 but they are publicly listed corporations. One was on the
18 American Stock Exchange, and one was on the New York Stock
19 Exchange. It ended up being a hostile takeover.

20 However, the Board of Directors of Day Mining Company
21 wanted to compensate their president; so, when this takeover
22 fight was going on, their president had been president for
23 some 20 years and had made an average of 20 percent return
24 on investment for the stockholders, had really run Day Mining
25 Company well. And they didn't want it taken over. But they

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1 lost the takeover fight.

2 The president and a couple or three of the officers of
3 Day Mines had a year's compensation, in one case that I know
4 of, and two years in another. And it just seems to me like
5 that anything that would interfere with that would just be
6 totally improper for Congress to try to look at.

7 I mean, they did pay a guy's salary for two years, but
8 I think that was the price of the takeover.

9 Mr. Chapoton. I am not sure whether Senator Chafee
10 would agree. I think he might be concerned about that
11 situation.

12 What we were proposing, Senator Symms, would be that
13 if the compensation in connection with the other events
14 exceeded 200 percent of normal compensation -- some test --
15 then there would be a presumption that it was excessive
16 compensation and disallow the deduction to the company.

17 So, if it were a two-year salary, that would not be
18 excessive.

19 Senator Symms. Now, let's say, for example, that if
20 the executive in question had made big profits in terms of
21 equity for the stockholders, how else can they compensate
22 if he or she did not have stock options?

23 Mr. Chapoton. They would pay more compensation annually,
24 I mean simply increase his salary.

25 The sole question is whether this is reasonable

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1 compensation for past services or not. It is the sense of
2 Senator Chafee and I think others on the committee -- this
3 of course is not our proposal, but others' on the committee --
4 that there should be some penalty, I guess is the way they
5 would phrase it, attached to providing excessive compensation
6 when they leave.

7 Senator Symms. What you are saying is not having a
8 penalty on the employee, but to say that the corporation, if
9 they wish to pay him, that they either pay him more that year
10 or else they would have to declare it like a dividend.

11 Mr. Chapoton. That's correct. It would be disallowed as
12 a deduction to the company.

13 Senator Symms. That is your position and Treasury's?

14 Mr. Chapoton. Yes.

15 I believe Senator Chafee would accept that.

16 Senator Symms. Well, it seems like that would be much
17 better, Mr. Chairman, than what Senator Chafee's proposition
18 is, as far as I would be concerned.

19 But I get concerned when Congress tries to come in and
20 tell the American citizens that they know what is best for
21 their stockholders and what is best for the board of
22 directors, and everything. That is my concern.

23 I like your approach much better. I would rather do
24 anything about it.

25 Mr. Chapoton. I think we would tend to agree with you,

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1 chance to look at it.

2 Senator Armstrong. Mr. Chairman?

3 The Chairman. Yes?

4 Senator Armstrong. I am not trying to delay action on
5 it, but how can we agree to it if the definition question
6 has not been resolved?

7 The Chairman. Well, in effect we give him a veto over
8 it, I mean just tentatively approve it. If he is not
9 satisfied, we'll bring it back.

10 Senator Armstrong. All right.

11 The Chairman. Is that all right with you, Steve?

12 Senator Symms. Well, I guess so. I mean, it seems
13 like an area we didn't need to fool with.

14 You are talking about everything we do is prospective,
15 though?

16 Mr. Chapoton. Yes.

17 Senator Symms. All right.

18 The Chairman. All right. Number 6?

19 Mr. Chapton. Number 6 -- Senator Boren. I am not sure
20 whether the committee acted on this or not. We are unclear
21 on the extent of your amendment, Senator Boren, on the
22 prepayment provision. We are particularly concerned as we
23 had subsequently understood that the restriction on highly
24 leveraged deals would not apply.

25 Our original proposal, just to retrack, the Treasury's

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1 understand that there is a lot of concern. Are you getting
2 into the farming thing separately? I thought we were
3 going to exempt --

4 The Chairman. I think what they are concerned about is
5 something that was written up in Newsweek this week.

6 Mr. Chapoton. Yes.

7 The Chairman. About holsteins.

8 Senator Boren. I haven't read that, but I was told
9 briefly about it.

10 I have just been hearing from the cattlemen's association
11 groups, and the ABA section on agricultural tax law and the
12 cattlemen's associations themselves, I think, where people
13 raised the question, complained about this 6-to-1 or 8-to-1
14 write-off, and I am certainly sympathetic with doing
15 something about that.

16 The Chairman. That's right.

17 Senator Boren. But there is a lot of concern about
18 changing the definition of "farmer" under the Farm Syndicate
19 Act, but I don't know that we have had a full test of that
20 definition yet in a court.

21 I am just hearing a lot of concern that we might be
22 getting into something here.

23 Mr. Chapoton. I don't think we need to change that
24 definition, Senator; but let me look into that. We will
25 report back to you.

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1 I guess our main concern is that this proposal not
2 exclude the basic highly-leveraged transactions.

3 Senator Boren. No, I am not trying to do that, but I
4 do want to include the highly-leveraged people. But I
5 think we had better be awfully careful we don't do something
6 here that causes a technical glitch in the laws in terms of
7 the definition of "farmer" and the rules that apply under the
8 Farm Syndicate Law, because we could really knock out the
9 whole feedlot business if we were to do that. I know that
10 is not intended, but --

11 The Chairman. Right. I think Senator Grassley has done
12 a lot of work on this. He will be here at 11:30, so maybe
13 we can pass this.

14 Senator Boren. I know he does have a concern about that,
15 too, so maybe we can put our heads together.

16 The Chairman. We want to shut down the highly-leveraged
17 operations.

18 Mr. Chapoton. That's right. Of course, some of the
19 feedlot operations do use outside money and are highly
20 leveraged. So we may --

21 The Chairman. Well, that would shut them down.

22 Mr. Chapoton. Well, that was our thought.

23 The Chairman. Some of those are 8-to-1, I understand.

24 Mr. Chapoton. Yes, sir.

25 The Chairman. Number 7?

1 subject to the disallowance rule. And we were trying to
2 get clarification on exactly how that would apply.

3 Senator Heinz. I don't know what it means.

4 Senator Boren. Could you walk us through the example?
5 I didn't read the example in Newsweek, but could you walk
6 us through that?

7 Mr. Chapoton. I'll let Mr. Pearlman go through what
8 we refer to as "the Shultz cattlefeed tax shelter."

9 Mr. Pearlman. Yes. In the Shultz-type deal, and
10 indeed I think in the typical highly-leveraged cattle deal,
11 a city dweller is approached to purchase X-number head of
12 cattle. He doesn't necessarily do it through a partnership;
13 he just purchases them directly.

14 He borrows funds. They may well be fully non-recourse
15 borrowings, or in the Shultz deal it is typically a mix of
16 recourse and non-recourse borrowings.

17 Those funds are used to acquire the cattle and to make
18 prepayments, the feed prepayments, and that is what we are
19 talking about in the prepayment rule.

20 The cattle are put on a feedlot and they are managed by
21 someone on behalf of the investor, and he will report then
22 expenses in connection with feeding those cattle on his tax
23 return -- not as a partner, necessarily, but just as the
24 owner of the cattle.

25 In that case, he will claim a deduction typically at

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1 year end for an amount of feed that is based on the feed
2 commitment that was made with his borrowed funds. So he
3 might have put a thousand dollars of equity in the deal and
4 borrowed \$7 or \$8000 and gone out and made a commitment to
5 purchase \$8-9000 of feed. He will take a deduction for the
6 \$8-9000. That's the leverage we are talking about.

7 Senator Heinz. Now, what happens after that?

8 Mr. Pearlman. Well, the benefit of the cattlefeeding
9 deal from a tax shelter standpoint is that the investor
10 accelerates the deduction into the earlier year.

11 Senator Heinz. He was going to have to buy the feed
12 at some point, and what you are objecting to is that he is
13 buying it all at the end of the tax shelter, right?

14 Senator Symms. What you want him to do is to pay the
15 interest on the money. That is what you are saying. You
16 want him to pay the government interest, that is the fact of
17 the matter.

18 What I would say everybody ought to do is to go do one
19 of those deals. They will find out when the price cattle
20 drops 15 or 20 cents they will really get burned. And that's
21 what happens about half the time.

22 Senator Heinz. Excuse me, Steve. Could I just track
23 this through?

24 Now, what happens in the next taxable year?

25 Mr. Pearlman. In the next year, when the feed is needed

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1 Senator.

2 Senator Boren. Well, isn't it the case that the ABA
3 argued that what you have just gone through, the Shultz
4 example, violated current law? And they turned them in
5 saying that the people that did this didn't meet the active
6 management definition under current law? Isn't that the
7 case?

8 I don't understand why Treasury doesn't just go ahead
9 and enforce current law. What I'm worried about is, we
10 might be going into a thicket here in terms of changing the
11 definition of "active farm management," when the ABA
12 apparently turned these people in and said, "We think they
13 are violating what the law is now in terms of active
14 management.

15 Mr. Pearlman. Well, the problem, Senator -- I think the
16 Internal Revenue's position is that it is violative of
17 current law. But the problem we've got is in the definition
18 of "active management," and that's what we hope to try to
19 deal with here.

20 After some period of years in litigating the
21 definition of "active management," we may know whether that
22 is the law or not.

23 Senator Long. I would like to ask just one question
24 about this situation. Now, the way we drafted these tax
25 reform laws in the beginning was that Treasury would do a

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1 study, and it would pick out the people -- or the Treasury
2 would, for us. They would pick out these tax returns,
3 a cross section, so we could see what percentage of taxpayers
4 made a lot of money and paid us either zero tax or less than
5 10 percent on their economic income.

6 Then we tried to focus on that for tax reform purposes,
7 and we tried to work to the point where people just couldn't
8 get by without paying us some amount of tax.

9 Now, I have not seen any of those studies in recent
10 years. Have you kept those studies up year by year, where
11 we can look as sort of a scorekeeper to see how many people
12 made a million dollars, for example, and paid us less than
13 1 percent in taxes, and that type of thing?

14 Mr. Chapoton. Yes. We have breakdowns across income
15 classes on total taxes paid. I think you are referring to
16 studies that were done in the early 1970s, picking out
17 particular tax returns. I believe there were 200 and some
18 odd tax returns above AGI, above \$300,000, on which no tax
19 was paid.

20 Senator Long. We had it both ways. Do you have it both
21 ways now?

22 Mr. Chapoton. No. I am just saying we have it across
23 income classes. That is the only thing that I am clear we
24 have.

25 Mr. Brockway makes a point that is absolutely correct,

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1 that when you use adjusted gross income, which is what we
2 usually use, the shelter deduction is taken before you arrive
3 at adjusted gross income. So you have to somehow build that
4 back in if you want the figures you are talking about. We
5 have not got that.

6 Senator Long. Well, let me ask someone from the Joint
7 Tax Committee. My impression was that we put something in
8 the law that requires the Treasury to give us a study, year
9 by year, as to what percentage of taxpayers were getting
10 by, were making a lot of money in economic terms and getting
11 by with paying us little or no tax. Is that still being
12 done?

13 Mr. Wetzler. Yes, that is, Senator Long. I think the
14 point is that they compute this study based on a concept
15 called "expanded income," which is adjusted gross income
16 plus a list of about 13 or 14 tax preferences.

17 I think the problem we have here is that not all the
18 preferences that people use to generate tax shelter losses
19 are in this expanded-income concept, because a lot of them
20 don't appear as separate items in your tax return. We don't
21 really have data on them.

22 This prepayment of feed is an example of an item which
23 is not on the tax return, and therefore Treasury can't really
24 measure that in its study. But they do publish the study
25 every year, and it does provide useful information; but it's

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1 not comprehensive.

2 Senator Long. I want to ask you gentlemen -- Mr.
3 Brockway, and you also, gentlemen on the Joint Tax
4 Committee staff -- to sometime soon come by and bring them.
5 I would just like to take a look at them and see how well
6 we are doing, because it seems to me that every Congress --
7 we ought to focus on these situations where people are making
8 a lot of money and paying no tax, and just keep looking at
9 that.

10 Mind you, the way it would have been most effective
11 in the past was to go pull the tax returns -- go pull some
12 returns and see how the people are getting away with it --
13 and then zero in on them to see that they are not going to
14 get away with that in the future.

15 In that area, my thought is that it is not a matter of
16 getting a lot of revenue for the government; it is just a
17 matter of tax justice and equity, and how this system is
18 perceived by taxpayers out there who pay us a lot of money.

19 I see you are nodding, Mr. Chapoton. You agree with
20 the concept.

21 Mr. Chapoton. I do.

22 Senator Long. We all agree, I think, that while we want
23 to provide incentives and all of that, we don't want to go so
24 far with tax incentives that somebody makes himself a
25 million dollars and pays the government nothing, while other

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1 people are working very hard for this country and pay a huge
2 amount of taxes.

3 All right now. Insofar as you are getting at that, I
4 want to offer you my full cooperation. But I am concerned
5 about using this in a situation where you might run counter
6 to the national interest by zeroing in on some fellow who
7 is already paying his share of taxes. That is the kind of
8 thing I think we ought to try to avoid, and I hope that that
9 is what we are all trying to do here.

10 Mr. Symms. Mr. Chairman, I want to ask another
11 question that pertains to that. I'll let Senator Long
12 finish, then I have a question.

13 Senator Long. No, I'm finished.

14 The Chairman. I think we can get that information.

15 Can we do that, Buck?

16 Mr. Chapoton. Yes, sir.

17 Frankly, I am a little surprised about the study, but
18 if we publish a study every year I certainly want to see it
19 as well.

20 (Laughter)

21 Senator Long. You come from Houston, Texas, don't you,
22 Mr. Chapoton?

23 Mr. Chapoton. Yes, sir.

24 Senator Long. Well now, one year we wrote one of these
25 tax reform laws, and we finalized it about the month of

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1 December. And you had an outstanding citizen in that area
2 of Houston who advised people on investments and taxes, and
3 all the rest of it. I think he was proud of the fact that
4 never since they wrote an income tax, if I am correct, had
5 this fellow paid an income tax. He paid one that year,
6 because he didn't get time to plan around it. So it happened
7 just too late in the game for him to reconsider all of his
8 investment decisions and get out of the line of fire.

9 I would hope that we would do a good enough job where
10 everybody gets caught, including that good, highly-regarded
11 person that I have in mind. And we want them all to learn
12 what it feels like to pay some taxes.

13 It is not that we have to get all that much; we just
14 don't want them to get by and then go around bragging that
15 they didn't pay the government anything.

16 Mr. Chapoton. I agree, Senator. There is a very
17 serious perception problem in that area.

18 The Chairman. Senator Symms?

19 Senator Symms. Thank you, Mr. Chairman.

20 Well, Mr. Chairman, if our goal here is to study what
21 has happened with people who are playing by the rules that
22 haven't paid taxes, then we are going to change the rules on
23 them; well, then maybe we ought to go back to ground-zero and
24 put in some kind of a flat rate tax or a national sales tax,
25 or something, and get rid of this Tax Code, so everybody will

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1 move this deduction into an earlier year and create a loss
2 when he has no economic loss.

3 Senator Symms. So, your contention, then, is that if
4 he feeds the cattle in advance, he can't take the deduction
5 until the cattle --

6 Mr. Chapoton. Once he feeds the cattle, no problem;
7 the cattle is deductible. Our question is when he prepays
8 for the feed and the feeding occurs the next year.

9 Senator Symms. Well, how does this affect the farmer
10 who prepays for fertilizer?

11 Mr. Chapoton. It would not have any effect. The farmer
12 is excluded.

13 Senator Symms. All right. It still seems like Treasury
14 wants it both ways to me, Mr. Chairman, but maybe I don't
15 understand the point here.

16 The Chairman. I think what we have agreed to do on
17 this is to get together on it during the noon hour, if we
18 can. We have to make some decisions.

19 Let's go back to Number 3. I see Senator Bradley is
20 here. Maybe we can just have a vote on that provision.

21 Senator Bradley. Mr. Chairman, I would still object
22 to this provision. The issue is really whether we are going
23 to fund the Superfund Bill or not. Everyone knows that
24 toxic wastes are a serious problem in this country, and the
25 question is whether the chemicals that were listed in the

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1 bill are going to be taxed or whether they are not going to
2 be taxed.

3 Everyone also knows that the amount of money that has
4 been allocated to the Superfund, \$1.6 billion, is not nearly
5 enough to do the job.

6 The Administration says that it is going to cost
7 between \$8 billion and \$16 billion to clean up toxic wastes
8 in this country.

9 I would hope that we are going to consider the
10 reauthorization of the Superfund Bill, which is due to expire
11 in 1985, in the next several months. And I think that it
12 would be an appropriate time to wait until that
13 reauthorization process before we address this question.

14 Let me remind the committee that the chemicals involved,
15 benzene, toluene, and xylene, all of which are found in the
16 process of making gasoline through the refinery, since
17 1980 have been found to be a very serious contaminant of
18 groundwater in this country. Gasoline is leaking from
19 underground tanks and is a significant threat to the
20 groundwater of our nation.

21 We can continue to say that there were tacit agreements,
22 which were not written into the law. The opposite is the
23 case. And that we will deal with this issue later; but let
24 me say, Mr. Chairman, I think that the issue needs to be
25 dealt with today, and that we would make a mistake in

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1 actually voting today on this. It would make a lot more
2 sense if we postponed this to a discussion of the whole
3 Superfund reauthorization.

4 I would hope that the committee would do that.

5 Mr. Chapoton. Senator, if I might -- I think that you
6 fully understand this, but the only point I think I would
7 add is that the whole composition of the Superfund tax is a
8 pretty complex item: what chemicals ought to be taxed, and
9 what ought not to be taxed.

10 It is clear in my mind, after reviewing the
11 legislative history, the revenue estimates, that this
12 amendment would change, would technically make the bill
13 provide what was intended when the Superfund was enacted.
14 And if you don't do it, you have shifted the burden of the
15 tax from where it was intended to be placed. It would not
16 affect the overall amount going into the Superfund. I
17 think the question you are raising could clearly be dealt
18 with in consideration of extension of the Superfund, but we
19 think this is just a technical error.

20 Senator Bradley. Could you tell me, Mr. Chapoton, how
21 much money is in the Superfund now and how much has been
22 raised?

23 Mr. Chapoton. No. I do not have those figures with
24 me. I could certainly get that full information for you.
25 I could get it for you in a couple of hours, if you wish.

1 Senator Bradley. Mr. Chairman, we are essentially
2 removing \$500 million from what would be in the Superfund.
3 Now, it might have been a mistake; there might have been a
4 tacit agreement. There are a lot of tacit agreements in
5 this room until a vote is actually taken. And I think we
6 make a mistake in taking \$500 million away from the
7 Superfund, absent a reauthorization of that bill and a
8 commitment by this Congress that we are going to spend the
9 money necessary to clean up toxic waste.

10 Senator Boren. Isn't it true, Mr. Chapoton, that it
11 sunsets when it reaches a certain figure?

12 Mr. Chapoton. Yes.

13 Senator Boren. So that all we are doing is just shifting
14 the burden as to who will pay that figure.

15 Mr. Chapoton. My complete understanding is that we
16 are only shifting the burden, not the total amount that
17 goes into the Superfund.

18 Senator Bradley. But what is now in the Superfund?
19 The law is due to expire in 1985.

20 Mr. Chapoton. I will have to get that figure for you,
21 Senator.

22 Senator Boren. Mr. Chairman, I certainly support the
23 Superfund, and I support the efforts to clean up toxic waste;
24 but I think at the time the bill was put together there was
25 a determination made as to the relative hazards, what was

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1 rush to try to get this thing through.

2 As I understand it, what it is collecting is what we
3 thought it was going to collect and what the Treasury
4 thought it was going to collect. Is that correct?

5 Mr. Chapoton. That is my understanding. Yes, sir.

6 Senator Long. All right.

7 And that was the estimates. That's how it has been
8 collected. Then someone said, "Hold on just a minute; this
9 is susceptible to a different interpretation." And if that
10 were the case, it would amount to what is being described
11 here as \$500 million of additional taxes.

12 Now, that wasn't what the Treasury thought they were
13 recommending, that's not what we on the committee thought
14 we were doing, that's not what anybody who understood what
15 the burden was going to be thought it was going to be.

16 So, if we insist on not correcting this area, it could
17 perhaps result in letting a \$500 million retroactive tax,
18 a backbreaking tax on many companies that they don't have
19 the money to pay for, which nobody every intended. And to
20 assess that kind of a tax is not necessary, when as a
21 practical matter we are willing -- I know I am, and I think
22 the majority of us are willing -- to vote whatever it takes
23 to fund the environmental aspect of the Superfund. But we
24 don't think you ought to do it in a retroactive fashion;
25 we don't think you ought to do it by blindsiding people and

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1 sneaking up on them from the year. We think that you ought
2 to tell them what you are going to do, and give them a
3 chance to state their case, and try to treat taxpayers fairly.
4 To do otherwise, we think, would be the wrong approach.

5 Now, if more money is needed, I am willing to do it.
6 But I think it ought to be done prospectively; it ought to
7 be done where the taxpayers understand what is being done
8 to them.

9 The Chairman. As I understood, this initially came up
10 as one that everyone agreed the proper interpretation, as
11 indicated by Senator Long and Senator Boren. I think we
12 might as well vote on it.

13 Senator Bradley. Mr. Chairman, I will be very brief.

14 The Chairman. All right.

15 Senator Bradley. The letter of the law says,
16 specifically, that these chemicals will be taxed. The tacit
17 agreement that was found in a colloquy after the law
18 passed has a different interpretation.

19 The Treasury and the IRS issued a ruling that, yes,
20 these chemicals should be taxed. The question is whether
21 we are going to do that, or whether we are now going to
22 exempt them pursuant to some tacit agreement after the law
23 was already passed, and absent any information as to how
24 much is presently in the Superfund, whether we are even going
25 to get to the \$1.38 billion that is supposed to come from

1 taxing these chemicals, much less whether we are going to get
2 the appropriations that were supposed to bring it up to
3 \$1.6 billion. That is what the committee is voting on.

4 The Chairman. Rod?

5 Mr. DeArment. Mr. Packwood?

6 Senator Packwood. Aye.

7 Mr. DeArment. Mr. Roth?

8 (No response)

9 Mr. DeArment. Mr. Danforth?

10 Senator Danforth. Aye.

11 Mr. DeArment. Mr. Chafee?

12 (No response)

13 Mr. DeArment. Mr. Heinz?

14 Senator Heinz. Pass.

15 Mr. DeArment. Mr. Wallop?

16 The Chairman. Aye.

17 Mr. DeArment. Mr. Durenberger?

18 (No response)

19 Mr. DeArment. Mr. Armstrong?

20 Senator Armstrong. Aye.

21 Mr. DeArment. Mr. Symms?

22 Senator Symme. Aye.

23 Mr. DeArment. Mr. Grassley?

24 (No response)

25 Mr. DeArment. Mr. Long?

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1 Senator Long. Aye.

2 Mr. DeArment. Mr. Bentsen?

3 Senator Boren. I have a proxy. Aye.

4 Mr. DeArment. Mr. Matsunaga?

5 (No response)

6 Mr. DeArment. Mr. Moynihan?

7 (No response)

8 Mr. DeArment. Mr. Baucus?

9 (No response)

10 Mr. DeArment. Mr. Boren?

11 Senator Boren. Aye.

12 Mr. DeArment. Mr. Bradley?

13 Senator Bradley. No.

14 Mr. DeArment. Mr. Mitchell?

15 (No response)

16 Mr. DeArment. Mr. Pryor?

17 Senator Boren. Aye, by proxy.

18 Mr. DeArment. Mr. Chairman?

19 The Chairman. Aye.

20 Senator Packwood. Change my vote to No. I thought we
21 were voting for Bradley when I voted Aye.

22 The Chairman. On this vote the Yeas are 9 and the
23 Nays are 2. The absent Members can record their votes, and
24 knowing what can happen around here, this could change.

25 (Laughter)

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1 Senator Symms. Mr. Chairman, did you do Number 5?

2 The Chairman. Number 5? Yes. That's a matter that
3 Senator Kasten called our attention to.

4 Senator Symms. Is there a sheet anywhere that
5 explains what was finally agreed to on Number 5, that we can
6 look at?

7 The Chairman. We explained it twice.

8 As I understand, there is no objection to Number 2.
9 Senator Durenberger raised that question. It was -- again,
10 I think correcting an error made in 1975, and without
11 objection we can approve that one.

12 Number 7?

13 Senator Matsunaga. Mr. Chairman, before we go, could
14 I be recorded as having voted Aye on the last vote?

15 The Chairman. Yes.

16 Number 1, the modification of income averaging, does
17 anyone want to vote on that? If not, we can agree to that.

18 Senator Heinz. Which one was that, Mr. Chairman?

19 The Chairman. Number 1. Hopefully we can move on.

20 Number 7 -- Senator Moynihan has a direct interest in
21 that. He is tied up in the snow.

22 Number 8, Senator Packwood will be meeting with Treasury.
23 In fact, I think we hope to have some resolution of that one
24 today.

25 Let's go to Number 9.

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1 Mr. Belas: Mr. Chairman, Number 9 deals with
2 voluntary remployee retirement savings accounts. These
3 things are qualified plans that involve only employee
4 contributions. They are being marketed in a manner very
5 similar to a checking account, where an employee is able
6 to put his money into this plan, write checks against that.

7 The proposal would say that the amounts that are
8 withdrawn from the plan would first come from the income that
9 is tax-deferred while it is in the plan, and only when the
10 income is exhausted will it come from the investment that
11 is put in by the employee.

12 This is similar to a proposal that is in the House bill,
13 but the House bill would say that these kinds of plans are
14 not allowed at all.

15 The Chairman. All right. Without objection, we will
16 agree to that provision.

17 Number 10? Dave?

18 Mr. Chapoton. Oh, the estimated tax payment,
19 Mr. Chairman?

20 The Chairman. Right.

21 Mr. Chapoton. I understand that we still need to get
22 Senator Grassley's okay on this, but just to give you the
23 considerations on both sides, I think, one, we do want some
24 ability to abate penalties on estimated tax payments in
25 hardship cases and in other situations where abatement would

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1 relieve an unintended or an unfortunate situation; but at
2 the same time not to have an across-the-board reasonable
3 allowance for abatement of the tax so that everybody who
4 fails to pay their estimated tax sends in a claim for a
5 reasonable basis, and therefore the estimated tax won't
6 come in.

7 The Chairman. A number of our colleagues have an
8 interest. I think we all want to do what Treasury wants to
9 do, and unless there is some objection.

10 Mr. Chapoton. Yes. The problem right now that we
11 should correct is, we have no ability to abate the tax in
12 the case where you would clearly abate it if you had any
13 ability to do it. And that we want the authority to do.
14 I think that is the principal case.

15 The Chairman. I think we agree with the concept, so
16 maybe we can agree to that and leave it up to you and
17 Senator Grassley and the staff to try to work it out. I
18 think this is raised in his subcommittee.

19 Mr. Chapoton. Yes, sir.

20 The Chairman. And I think also Senator Kassebaum and
21 others have indicated an interest in this.

22 Number 11?

23 Mr. Chapoton. Number 11 --

24 The Chairman. That is one that Senator Mitchell has
25 concerns about. He is not here right now.

1 Well, that is another one that I understand Treasury
2 is working on with a number of Senators. Is that correct?

3 Mr. Chapoton. Yes. I am just informed that some of
4 the charitable interests that have been concerned about that
5 would agree to the 150 percent overvaluation -- the present
6 penalty that you have adopted of 150 percent overvaluation --
7 if there is an ability to abate the tax where there is a
8 clear showing of a reasonable basis for the value claimed.

9 If that language is satisfactory -- or if we can work
10 out satisfactory language -- we would agree with that. It
11 would be a stringent penalty -- I want to make this clear --
12 on overvaluation by more than 50 percent, a 50-percent
13 overvaluation; but there would be authority where a clear
14 good faith attempt has been made to arrive at the correct
15 value, we would have the authority to abate that and not
16 apply that penalty.

17 Senator Armstrong. Mr. Chairman, my question is not
18 related to that, but the question is: Whether or not, in the
19 process of adopting this reform, we are qualifying any new
20 kinds of property for this treatment.

21 Specifically, as I understand it, literary manuscripts
22 and that kind of stuff are not -- an artist or an author
23 cannot at the present time deduct the market value of his
24 own manuscript.

25 Mr. Chapoton. That is correct, Senator Armstrong.

1 Senator Armstrong. Does this broaden that?

2 Mr. Chapoton. It does not.

3 Senator Armstrong. It does not?

4 Mr. Chapoton. No, it does not. That has been
5 suggested and has been considered by the committee, but it
6 has not been adopted by the committee.

7 Senator Armstrong. Well, as long as it is not in this
8 proposal, then I will defer my comments on that until it
9 comes up, if it ever does.

10 Senator Danforth. Mr. Chairman, I want to commend
11 Secretary Chapoton for attempting to work something out.
12 If this is all right with him, it is all right with me.

13 I would just ask, though, how would a taxpayer make
14 a clear showing of a good-faith effort?

15 Mr. Chapoton. Senator, I said as long as the language
16 is satisfactory I want to see that also. It has to be
17 more than simply picking an appraiser and not looking beyond
18 that. We would have to make it clear that one would have
19 to go extraordinary lengths to have arrived at the proper
20 value, if in fact he misses the value by more than 50 percent.

21 Senator Danforth. But how would you know that he had
22 missed the value?

23 Mr. Chapoton. For that, it would be on final
24 determination in the court or by agreement of the taxpayer
25 as to the actual value.

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1 I would be happy to go over the language, but I want to
2 go over that language myself, on just how that clear showing
3 is made.

4 The Chairman. I think Senator Mitchell has the same
5 concern. He is here now, too, so maybe you can work it out.

6 Senator Danforth. Well, it's fine with me. I mean,
7 I think this is a step in the right direction; I was just
8 curious as to how such a clear showing is made, because all
9 you are doing is getting an appraiser to make an estimate.
10 I mean, any time you get any appraiser you are making some
11 showing of an attempt to get a value. So what would you get?
12 Two appraisals?

13 Mr. Chapoton. Well, an appraiser who is very
14 knowledgeable in the area. Sometimes there are appraisers,
15 and then there are appraisers, and you need to -- we have
16 discussed a number of factors in my office last night, and
17 I have to agree with the general thrust of your comment,
18 that it is difficult to make a clear showing.

19 It is our feeling that a penalty which is rather
20 stringent if one selects a value that is excessive will tend
21 to make taxpayers select more reasonable valuations. But
22 where they can show to the Internal Revenue Service, and the
23 Service agrees, and that agreement would not be second
24 guessed except where there is an abuse of the Service's
25 discretion, then I think we would go a long way to correcting.

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1 the problem.

2 Now, that doesn't directly answer your question of how
3 one is going to make a clear showing that he attempted in
4 good faith to arrive at the value, and I will just have to
5 work on that language further.

6 The Chairman. Senator Mitchell?

7 Senator Mitchell. Well, Mr. Chapoton, while it may be
8 proved that a penalty as severe as this one will have the
9 effect you described on the taxpayer, it will also plainly
10 have another effect, and that is a chilling effect on the
11 whole process or on the whole concept of deductions of this
12 nature, and that is what charities are concerned about.

13 Neither of us, of course, can demonstrate what will
14 happen in the future, but it seems clear that the latter
15 effect is more likely to occur than the former.

16 Since the proposed penalty is so severe, I wonder if
17 you could explain why Treasury objects to some form of
18 sliding scale as a substitute, that would in fact impose
19 this penalty only in those extreme cases where, just by the
20 size of the gap between the actual value and the claimed
21 value, lack of good faith is obvious? Senator Danforth asked
22 the question, and the answer to the question is really that
23 whether or not it is in good faith will depend only in part
24 on the appraiser, but it will also depend on the only
25 objective factor in the whole thing, and that is the

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1 difference between the actual value as established and the
2 claimed value.

3 If you come into court with the best appraisers in the
4 world, but you have claimed \$10,000 for something that
5 someone says is valued at \$100, you are not going to be
6 able to establish as good faith as you would if you had
7 come in with one appraiser who doesn't know anything about
8 the subject but the difference is only a very small margin.

9 Mr. Chapoton. True.

10 Senator Mitchell. And that is really the problem in
11 establishing good faith. It doesn't really have very much
12 to do with the quality of the evidence; it has more to do
13 with the two simple facts -- what is the actual value and
14 what is the claimed value.

15 Senator Armstrong. Senator Mitchell, if you would
16 yield to me, I would just asked, in the example you have
17 cited, how the subsequent value is established. I mean,
18 you contrasted the appraised value at the time a gift is
19 made with the actual value. When you say "the actual
20 value," what do you mean, and how is it established?

21 Senator Mitchell. Well, it is either an agreement
22 hopefully, between the taxpayer and the IRS or it goes to
23 court, and after hearing the evidence a judge decides the
24 value.

25 Senator Armstrong. When it goes to court, my assumption

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1 is that the way the court would determine what the actual
2 value is is through somebody else's appraisal.

3 Mr. Chapoton. It takes testimony. It may appoint its
4 own appraisers, but it usually just takes testimony from the
5 IRS appraisers and the taxpayer's appraisers.

6 Senator Mitchell. Then because a judge says it, it is
7 objective rather than subjective?

8 Senator Armstrong. Well, I respectfully say that I have
9 some skepticism about that, number one. And number two, even
10 property where there is an objective test -- and that's the
11 market test -- I don't think anybody quibbles, for example,
12 that if you give to a charity stock that is listed on the
13 New York Stock Exchange, that if it sells on a certain day
14 at a certain price, that's the value of it. But even those
15 values can be off by more than 150 percent over a relatively
16 short period of time. I mean, even stocks in big, stable,
17 important companies change in value 100 percent in the course
18 of a year, many years.

19 So, I think we ought to be fairly cautious about this.

20 Mr. Chapoton. Senator, the test would not apply to
21 publicly traded stock.

22 Senator Armstrong. I understand that. But the point
23 I am making is that even where there is a completely
24 objective test, that is, a sale between a willing buyer and
25 a willing seller, the price of this stuff fluctuates all over

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1 but you have to have some procedure, and there must ultimately
2 be some determination -- that is worth \$100, and you claimed
3 \$151, and then you lose the whole thing, that seems to me
4 to be an excessively harsh penalty that will have a real
5 chilling effect on the whole process.

6 Mr. Chapoton. Well, Senator, the other approach that
7 we had talked about was a sliding scale, so that if it is
8 over 150 percent of value the taxpayer would lose as a
9 deduction half of the appreciation. And then you would slide
10 up to where if it is over 200 percent, he would lose the
11 entire amount. We had indicated that would be acceptable
12 to us. Being that precise, we would think the reasonable
13 basis out should not exist. I mean, that is just a
14 bright line objective test that taxpayers would have to
15 live with. As an alternative, that would be acceptable
16 to us.

17 Senator Mitchell. Well, I just think what has been
18 proposed will really have a severe adverse effect.

19 You suggested that the sliding scale would not have
20 a good-faith exception?

21 Mr. Chapoton. Yes. It would not have a good-faith
22 exception.

23 Senator Mitchell. Well, a good-faith exception makes
24 sense. Why not keep it?

25 Mr. Chapoton. Because you have then reduced the

1 penalty very significantly, except in the case -- ideally
2 we would avoid the good-faith exception, because that brings
3 back into the question the very point that Senator Danforth
4 is making: When do you really know that?

5 So if you reduce the penalty significantly, and we would
6 be talking about in the over-150 case reducing the penalty
7 from the entire deduction to only half of the appreciation
8 in the property; you always get it full cost plus half the
9 appreciation as a deduction -- then we would think that might
10 be a desirable thing, and it would be a very objective test,
11 and there would be simply no argument on the good faith or
12 not. The taxpayer would simply have a small penalty if he
13 was more than 50 percent off.

14 Senator Mitchell. Well, I think that is better than what
15 you had before, although I think it should be --

16 Mr. Chapoton. Well, that is fine with us, if the
17 committee prefers that. That is certainly acceptable.

18 And it does move away from the problem that Senator
19 Danforth was concerned about.

20 Senator Mitchell. Well, let me just say that I think
21 that is an improvement, but I still -- and I think others
22 have concerns about it. Perhaps we can improve that and
23 reserve the right to work on it.

24 Mr. Chapoton. That is fine with me. But, Mr. Chairman,
25 I think what Senator Mitchell is talking about is a new

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1 discounting and changing what the principal amount is and
2 the interest amount in their obligation.

3 Mr. Chapoton. That is correct. The consumer
4 exception was on another provision in the House Bill, but
5 we think it would be a good change.

6 We are also suggesting that straight borrowing between
7 family members not be covered under \$10,000.

8 Senator Packwood. Now, wait. This refers to this
9 Dickman case, doesn't it?

10 Mr. Chapoton. No, this does not relate to that. This
11 is where original issue discount is imposed.

12 Senator Packwood. All right.

13 The Chairman. I think without objection we will agree
14 to that, and then we will move on to the next one that I
15 think there will be some discussion on, Number 13.

16 (CONTINUED ON PAGE 48) - NOTHING FOLLOWS THIS LINE

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1 Secretary Chapoton. Concern about the affect of
2 the Dickman case in earlier years. We had objected to a
3 forgiveness of gift taxes. That the Dickman case decides
4 should be imposed. But we can see some concerns where there
5 are smaller amounts involved, and in valuation the Dickman
6 case did not determine how you would value these items.

7 And so we are suggesting under the de minimis rules
8 adopted by the committee for the future, that taxpayers ought
9 to be able to elect, if they wish, to take advantage of
10 those rules for the past.

11 Senator Packwood. Something just strikes me as unfair
12 about this. And I heard the arguments earlier.

13 But you had the IRS adhering to one position. That the
14 family loans, interest free, were subject to taxation. They
15 lost that a time or two along the way in court. Is that
16 correct?

17 Secretary Chapoton. That's correct. They did.

18 Senator Packwood. And in one case they lost it in the
19 Court of Appeals and did not appeal that case.

20 Secretary Chapoton. Senator Heinz suggested that we
21 are getting the chronology on that. I'm not familiar with
22 that.

23 Senator Packwood. I'm trying to pick the theory now.
24 Apart from de minimis, let's take the theory of fringe
25 benefits. And do I understand that we have adopted amending

2
1 the amendment? We are going to, again, prohibit Treasury
2 from enforcing that for two years on taxation?

3 Secretary Chapoton. I understand the committee has
4 acted on that.

5 Senator Packwood. But the Treasury maintains its
6 position that those are still taxable. We are just going to
7 prohibit for two years and any money being used to enforce
8 it, right?

9 Secretary Chapoton. Well, I would be careful about
10 agreeing what we maintain is taxable or not. We are trying
11 to draw the line between taxable and non-taxable fringe
12 benefits.

13 Senator Packwood. I understand that. But for all of
14 those that are not exempt from taxation, although we
15 prohibit you from enforcing it, your theory is that those
16 are subject to tax.

17 Secretary Chapoton. That's correct. There are some
18 that we would say are taxable.

19 Senator Packwood. And that is the IRS' position?

20 Secretary Chapoton. That's correct.

21 Senator Packwood. Now we go two, four, six years down
22 the road and suddenly this perpetual two year moratorium
23 runs out, is it your theory then that you could go back and
24 tax all of those fringe benefits that were not exempt from
25 taxation but everyone thought they were exempt from taxation?

3
1 I mean the people who are receiving them.

2 Secretary Chapoton. Senator, I think you would have
3 to look at the particular benefit, but I think it would be
4 very unlikely. As we said when the moratorium expired, we
5 were not going to design; we were not going to change the
6 rules; we were not going to issue regulations going back and
7 taxing those benefits.

8 We made it clear that we were not going to do that.

9 Senator Packwood. I know you are not, but it's the
10 same in theory as wanting to now go back and levy the gift
11 tax on the beneficiaries under the Dickman case. It's a
12 retroactive application of what you said was your theory.

13 Secretary Chapoton. It is a retroactive allocation
14 theory. That's right. The Service took that and that the
15 Supreme Court --

16 Senator Packwood. I'm not going to quarrel with the
17 Supreme Court decision, but I feel very strongly it ought to
18 be made prospective in its application rather than allowing
19 Treasury to go back now or the Internal Revenue Service to
20 go back now after they have lost several cases in court and
21 say, well, that was our theory all along, and we were finally
22 sustained; and, therefore, all of these taxes, all these
23 gift taxes, we are going to demand be paid.

24 Secretary Chapoton. Senator Packwood, would that
25 involve a refund to the Dickman family as well?

4
1 Senator Packwood. Pardon me?

2 Secretary Chapoton. Would that involve a refund to
3 the Dickman family as well?

4 Senator Packwood. Theoretically it would, yes.

5 Secretary Chapoton. I mean I wonder about the
6 precedential affect of that if on every issue we litigate
7 and lose at some point but finally prevail --

8 Senator Packwood. It seems to me the precedent, Buck,
9 is the same as my theory about the fringe benefits. You are
10 not going to try and go back and collect taxes on those. But
11 that is more a decision that is pragmatic rather than
12 theoretical. Whereas, in this case, there are very few
13 enough people involved that you are saying we are going to
14 collect the taxes.

15 Secretary Chapoton. There is a great line drawing
16 question in the fringe benefit area, which you would try to
17 draw lines and then make those rules for the future clearer.
18 But I think that we can get the chronology on this.

19 The position, obviously, has been maintained that these
20 were taxable benefits, and it has been maintained enough to
21 take it to the highest court of the land. And that court
22 agreed they, indeed, -- there is a gift tax involved.

23 The Chairman. Could you just explain, Buck, quickly
24 what your provision would do? What number 13 does?

25 Secretary Chapoton. In the provision that we proposed,

1 which was before the Dickman case, we stated that there
2 would be exceptions for smaller -- that generally an
3 interest free loan would be treated consistent with the
4 economic substance. That is, as though interest had been
5 charged and paid and rebated.

6 So in the gift tax context, there would be a gift tax.
7 But there is an exception for loans of under \$10,000.00 to
8 a family member or under \$100,000.00 where the borrower was
9 a family member and had no investment income, except where
10 there was a clear intent to transfer investment income for
11 tax purposes.

12 Generally, those exceptions are going to apply for the
13 future to excuse most family member loans. We are simply
14 saying that a taxpayer, an earlier year, ought to have the
15 right to elect that for the earlier year under the Dickman
16 case.

17 The Chairman. And in the House bill, there is nothing
18 on this?

19 Secretary Chapoton. There is nothing on this matter.

20 The Chairman. So if we don't do anything --

21 Secretary Chapoton. Then there is no relief that
22 Senator Packwood would want.

23 Senator Heinz. Mr. Chairman.

24 The Chairman. Senator Heinz.

25 Senator Heinz. Mr. Chairman, we raised this issue last

1 week, and let me state for the record that I do not have --
2 emphasize do not have -- an interest free loan from anyone.

3 But last week it was argued -- and you have argued
4 today -- that there is a principle involved which is when
5 the IRS takes a position and it is litigated, and the IRS
6 prevails, that there should be a liability going back to the
7 time when the IRS litigated initially, and that that
8 establishes what the law has been all along.

9 And normally I would agree with you. I think that is
10 good policy. In this case, I suggest that what has been the
11 law all along has been clouded by other court decisions.

12 And although I asked you last week and again this week
13 to come up with the facts and circumstances surrounding the
14 various cases, I am going to have to rely so far on my own
15 research because we haven't, as far as I know, gotten any
16 information from you.

17 But I am advised that the first time this issue was
18 litigated, it started with a court decision in Johnson versus
19 the United States, 254 F. Supp. 73, ND Text, 1966. Twelve
20 years later the tax court and the Seventh Circuit Court --
21 that is in 1978 -- rebuffed the IRS' argument.

22 And apparently there was a second case -- Crown versus
23 Commissioner, 585 F. 2nd 234, also 1978 -- that came out the
24 same way.

25 I understand it was not until 1982, November 1st, 1982,

1 that the Federal District Court in the Dickman case first
2 ruled in favor of the IRS. So you had a series of court
3 decisions going up through 1978 which stated that the law
4 was contrary to the IRS contention.

5 And then for --

6 Senator Danforth. Could you yield to the Senator?

7 Senator Heinz. I will in a second. Let me just finish
8 the statement.

9 And then four years later, if my dates are correct --
10 November 1st, 1982 -- the IRS finally got a Federal District
11 Court to agree with them. Now why the position changed, I
12 don't know.

13 But it does seem to me that based on the fact that the
14 IRS did not take either Johnson or Crown to the Supreme Court
15 for a final decision, as I gather they are entitled to do,
16 it seems to me that either the decision standing alone created
17 a mind set as to what, in fact, notwithstanding the position
18 of the IRS, the law was, or that the IRS' failure to appeal
19 either Crown or Johnson to the Supreme Court suggested that
20 the IRS didn't think they could win. And, therefore, that
21 they were wrong.

22 So having said that, I gather Senator Danforth has a
23 point, but could you just allow Buck to respond to that?

24 Senator Danforth. Could I just interject a comment
25 before his response because I have to go? I'm sorry. I just

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1 have something I absolutely have to do right now.

2 But, Mr. Chairman, I don't know what your intention
3 is on voting on this question. I simply wanted to state
4 my disagreement with Senator Packwood and Senator Heinz,
5 and my agreement with Treasury.

6 I think that it would be a very bad precedent for us
7 to take the position that taxpayers can gamble. That they
8 are right, and that the Treasury is wrong, and that there is
9 absolutely no risk in the gamble at all.

10 That the longer they can drag out litigation, the more
11 taxes they will be able to avoid. I also think that Senator
12 Packwood's answer to Secretary Chapoton's question about the
13 Dickman family would render any assumption of jurisdiction
14 over the case unconstitutional because it would be a purely
15 advisory legal proceeding. There would be no risk at all
16 to the taxpayer.

17 So it would seem to me that this would be a very bad
18 precedent. And if in my absence there is a vote, I would
19 like to be voted against the Packwood-Heinz position.

20 The Chairman. Well, as I understand it -- again, I'm
21 going to make it clear that we are not going into the
22 retroactive bit here at all. Are we?

23 Secretary Chapoton. Yes. We do allow the retroactive
24 at elected -- the benefits for the future to be elective
25 for the past.

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The Chairman. That's true.

Mr. DeARment. It's retroactive relief.

Secretary Chapoton. Retroactive relief.

The Chairman. If we don't do anything, there's no relief at all.

Secretary Chapoton. It's de minimis.

Senator Packwood. What is your limit on de minimis?

Secretary Chapoton. It's \$10,000.00 per loan or \$100,000.00 from total loans from one family member to another where there is not outside investment income in the case of a borrower. And it's all subject to a tax avoidance.

Senator Long. Now let me ask you a question about that. Would that apply to a situation where a taxpayer owns a home and let's say his children live in that home rent free?

Secretary Chapoton. No, sir. This is where there is a loan involved. So it's a question of whether you have an interest free dollar loan.

Senator Long. Would it apply to a situation where a taxpayer owns a farm and permits his children to farm the land and pay him no rent?

Secretary Chapoton. Senator, that is not involved here.

Senator Long. Now on that though is the same principle. I mean, basically, there is --

Secretary Chapoton. No, because our concern here is where there is a loan of funds and then those funds by the

1 borrower are taken and invested, and then income is earned
2 which would logically be the income of the parents. So the
3 affect has been to transfer that income to a lower bracket
4 and to avoid a state and gift tax on it.

5 Senator Long. I can see that. But wouldn't the same
6 thing apply where a taxpayer has a home and permits his
7 children to live in the home, and simply pay the taxpayer
8 no rent? Wouldn't that be the same thing? It's exactly the
9 same principle, isn't it?

10 Secretary Chapoton. It is the same concept, but there
11 is simply not the avoidance possibility of a transfer of
12 wealth. The rent involved is the same concept.

13 Senator Long. Now let me --

14 Secretary Chapoton. But, Senator, what I'm worried
15 about here is that this was a highly touted method of
16 transferring wealth taxfree in the 70s. Because as I was
17 going to respond to Senator Heinz's point, it's clear that
18 the government lost case after case on this. And so the
19 taxpayers began to say this is a way to avoid the gift tax.

20 And, in fact, in some of the cases involving millions
21 and millions of dollars, you can transfer an unlimited amount
22 to a lower bracket. After a while, you get in the same
23 bracket, but it's certainly free of the transfer.

24 Senator Heinz. Mr. Chairman, that's my point. Buck
25 has stated on the record that the government did lose case

1 after case. And I don't think the Supreme Court decision is
2 wrong. I think it's right.

3 But that doesn't change the fact that the government
4 lost case after case and refused to appeal.

5 Senator Long. That concerns me. Now all during that
6 time we on this committee could have clarified that law to
7 your advantage, and there wouldn't have been any further
8 litigation. Isn't that right?

9 If we had wanted to, we would have clarified the law
10 to your advantage, at least to the advantage of the Treasury
11 anytime we wanted to.

12 Secretary Chapoton. Sure. I think there's some
13 question of stepping in everytime there is a case in
14 controversy and clarifying it. But you surely could have
15 done it.

16 Senator Long. Certainly it was within our power to do
17 so.

18 Now would you mind giving me the facts of that case
19 you referred to, the Dickman case.

20 Secretary Chapoton. The Dickman case is the Supreme
21 Court case.

22 Senator Long. How do you spell that?

23 Secretary Chapoton. D-i-c-k-m-a-n.

24 Senator Long. Now would you mind telling me just the
25 facts of that case? What I want to know is how big a loan,

1 and how much interest income were we talking about in that
2 case?

3 Secretary Chapoton. Senator, I don't have a copy of
4 the case with me. I believe -- the Lester Crown case,
5 which is --

6 Let me back up and disagree with one thing Senator
7 Heinz said. When you say the IRS did not appeal the cases,
8 the IRS cannot appeal, you cannot take an appeal to the
9 Supreme Court when there is not a conflict between the
10 circuits in cases such as this.

11 Senator Packwood. You can. You can. The Supreme
12 Court may or may not -- you can't take it as a matter of
13 right to --

14 Secretary Chapoton. That's right. But ordinarily they
15 will not. And in a tax case, they like to set up a conflict.
16 And they would not, I think, if there had not been a --

17 Senator Heinz. What you are saying is that the practice
18 of the court when there is no conflict and when one or two
19 circuit courts have ruled against you, the Supreme Court's
20 policy is to say the Circuit Court decision is the law of the
21 land; that's why we don't take --

22 Mr. Brockway. Ordinarily when the Supreme Court decides
23 whether to take a case, they will look for specific cases
24 where they hold a state statute unconstitutional, for example.
25 They will only take a case where there is a conflict between

1 the Circuits. The Lester Crown case was decided in 1978.
2 And in 1973, I guess, the IRS came out with its ruling saying
3 that these were taxable gifts. In 1977, the Tax Court
4 decided Lester Crown in favor of the taxpayer. It was
5 appealed. And that was upheld by the Seventh Circuit.
6 Nineteen seventy-eight is when they upheld it.

7 And the government non-acquiesce in that case, again,
8 stated that they disagreed. But that was not a case that
9 the Supreme Court would take because that was the first in
10 a series, I think, between 1978 and 1982. There were four
11 or five cases dealing with this issue where the government
12 lost. And then they won one Circuit Court case, and then
13 they also won one case in the Court of Claims.

14 Secretary Chapoton. Senator Long, in just looking at
15 the headnotes of the Dickman case, the loans were, the courts
16 points out, over a five year interval. Outstanding loans from
17 the father to a son varied from \$144,700.00 to \$342,900.00.
18 And then there were some loans involving a business owned
19 by the parent, to a business owned by the children, which
20 were covered as well.

21 Senator Long. Well, then, that would sound to me as
22 though you don't have here one of these horrible cases where
23 it involves a huge amount of money. You are thinking about
24 the fact that a lot of this was going on so in looking at all
25 the cases involved it amounted to a substantial amount of

1 money.

2 I would assume that what you are talking about -- how
3 much tax avoidance would be involved in that? The larger
4 loan was \$342,000.00.

5 Secretary Chapoton. The \$342,000.00. The fair market
6 value, if you will. The interest rate on that amount of
7 money. And to the extent it exceeded the then exclusion
8 of \$3,000.00 per donor, plus the lifetime exemption, which
9 probably then was \$30,000.00 per donor -- excuse me. The
10 \$3,000.00 is per donee and the \$30,000.00 per donor -- there
11 would be a gift tax. The separate gift tax rate would be
12 applied.

13 Senator Long. Like if the interest rate were 10
14 percent, you would be avoiding the gift tax on \$34,000.00,
15 I take it.

16 Secretary Chapoton. That's right. \$34,000.00 a year.

17 Senator Long. Thank you.

18 The Chairman. Senator Chafee.

19 Senator Chafee. Mr. Chapoton, explain to us here, if
20 you would, what has happened in other such cases. In other
21 words, when the Supreme Court makes a decision that A, B, or
22 C is taxable because a conflict has arisen in two circuits,
23 that's the law. And, thus, not only that person becomes
24 subject to the tax, but also whoever has fallen in that
25 category. Is that not right?

15
1 Secretary Chapoton. That's correct. That's not only
2 in the tax law, but in other areas as well. But in the tax
3 law when a Supreme Court finally decides an issue, taxpayers
4 who have filed returns on the other side of the issue are
5 then required to pay additional tax in accordance with that
6 decision. That's a long-standing practice.

7 Senator Chafee. Now how do we get into this particular
8 situation, seeking an excuse, if you would, for these people
9 who were picked up by the Dickman decision? What we are
10 attempting here, it seems to me, under the proposal is to
11 do something that is different than we have done in other
12 such cases.

13 Secretary Chapoton. You mean our proposal, Senator?

14 Senator Chafee. No. Your proposal is just to excuse the
15 de minimis ones, right?

16 Secretary Chapoton. Right.

17 Senator Chafee. Now the proposal before us is extended
18 to everybody.

19 Secretary Chapoton. Correct.

20 Senator Chafee. Now under that proposal isn't that
21 different from what we have done in every other tax case
22 on a Supreme Court decision?

23 Secretary Chapoton. Yes, sir. I know of no precedent
24 for it. Where we would overrule for the past a Supreme
25 Court decision.

16
1 Senator Chafee. And so what we have said in those
2 cases where we failed to take action, is that that's the way
3 the Court interpreted the law, and if you misinterpreted
4 that law, that's tough luck; you have to pay the tax.

5 Secretary Chapoton. That's correct. And that is what
6 has happened in the past, and what we thought would happen
7 here, of course.

8 Senator Chafee. Well, I don't understand the argument
9 of those who are saying that this is different. I know people
10 have relied on -- and I like everyone have received a number
11 of calls from people who are perfectly prepared to accept
12 what goes in the future, but they say that they have somehow
13 been impaled here because they relied on what appeared to be
14 the law, as the Circuit Court had interpreted it. And they
15 are losing out.

16 Secretary Chapoton. Senator, let me make one additional
17 point.

18 When they say they relied on the Circuit Court, they
19 did so, I would guess, in virtually every case, if not every
20 case, involving significant amounts, which would be all we
21 would be talking about. Under advice of counsel if the
22 Internal Revenue position is to the contrary and that this
23 case may yet be decided to the contrary.

24 Senator Chafee. Now how would they know that the
25 Internal Revenue Service views that to the contrary?

1 Secretary Chapoton. Because of a published ruling
2 in 1973, non-acquiescence in the adverse decisions, and
3 continuing to litigate the issue, and to --

4 Senator Chafee. And so what you are saying is that
5 these aren't innocent people that get into these --

6 Secretary Chapoton. I could not imagine that there is
7 an unadvised taxpayer where there is a significant amount
8 involved here.

9 Senator Bradley. Would the Senator yield?

10 Senator Chafee. Yes.

11 Senator Bradley. Let me ask Mr. Chapoton. You are
12 saying that if you were the tax lawyer for the client who had
13 the ruling at the Appeal Court, that you would have advised
14 him that the IRS still felt that these gifts were not in
15 accordance with the IRS' interpretation?

16 Secretary Chapoton. Absolutely. You would be
17 derelict in your duties if you did not so advise the tax-
18 payer.

19 Senator Bradley. And are you saying that, therefore,
20 it is your sense that anyone who acted on the basis of only
21 that court's ruling was doing so against what would be a
22 generally accepted practice for the tax attorney?

23 Secretary Chapoton. No. I would say the tax attorney
24 might have well said -- I think the government has lost a
25 lot of cases, as Senator Heinz has pointed out, and they may

1 ultimately lose the issue. But they are not giving up on
2 the issue. And it may go the other way.

3 Senator Bradley. And if it went the other way --

4 Secretary Chapoton. Then your transaction is going to
5 incur some gift tax.

6 But he would also add that you are not any worse off
7 than if you tried because if you transfer the wealth this
8 way, you are only doing what would otherwise -- it does
9 work. That is, you have transferred wealth. And the gift
10 tax is just that. It's a gift tax that you would have had
11 to pay anyway.

12 Senator Bradley. Could you give another example of
13 a situation where the Appeals Court ruled, the IRS didn't
14 appeal, then went to the Supreme Court and had the affect on
15 a group of taxpayers? In other words, the hypothetical that
16 Senator Chafee raised. Is there an example?

17 Secretary Chapoton. Yes, there would be an example.
18 In every tax case that gets to the Supreme Court, obviously
19 there are going to be parties on both sides, and almost ~~have~~
20 always have a conflict among the circuits, and always be an
21 issue of great significance so that there will be -- and
22 usually affecting a number of years earlier.

23 The Chairman. Buck, I don't want to cut off any
24 discussion of this, but it seems to me that we don't have to
25 do anything.

19
1 Secretary Chapoton. That's correct. There is no
2 action that is required.

3 The Chairman. We are just trying to provide a little
4 relief here. If people don't want to do it, I'm perfectly
5 willing to do nothing.

6 Senator Packwood. Well, Mr. Chairman, I want to make a
7 motion to make the law prospective from the date of the
8 Dickman case. And if that fails, we will go to the de
9 minimis situation. But I don't want to pass by this
10 situation without making that motion.

11 Senator Bentsen. There is just one comment I would
12 like to make since I have not been involved in this
13 proceeding.

14 The Chairman. All right, Senator Bentsen.

15 Senator Bentsen. I'm concerned about the problem of
16 enforcement and how you do it. It seems to me it would be
17 rather inconsistent treatment, and very difficult to pick up.

18 I understand that every one of these cases where some
19 action has been taken by the IRS has been the result of an
20 audit where they have been able to find it.

21 I'm also told that in trying to determine the
22 imputed interest that there has been a substantial variance
23 in that in that in every case -- I was told that in every
24 case -- filed by the IRS that they came up with a different
25 imputed interest. That's amazing is that's correct.

20
1 And if that's the case, then you see the kind of
2 difficulty that the taxpayer himself would have in trying
3 to determine what the interest rate is.

4 Secretary Chapoton. Senator, that's one of the purposes
5 of our proposal. The proposal for the future would set the
6 interest rate. And we are saying that a taxpayer could elect
7 that for the past.

8 Senator Bentsen. That's fine. And the taxpayer would
9 what?

10 Secretary Chapoton. Could elect that for the past.
11 Could elect that treatment. Because you are correct. It's
12 another valuation question. What is the value of the loan?
13 Someone has to delve into that question to see what wealth
14 has been, in fact, transferred.

15 We are proposing as a relief measure that for the
16 past year, if the taxpayer wanted to, he could claim a
17 value that he asserts if the fair interest rate, or he could
18 elect this amount and have the question settled. Elect the
19 rate established under this bill for the future.

20 Senator Heinz. Mr. Chairman?

21 The Chairman. All right.

22 Senator Heinz. Buck, under Dickman the court ruled
23 that gift taxes would apply.

24 Secretary Chapoton. Correct.

25 Senator Heinz. It would apply to the interest not paid.

1 The gift tax, I'm told, was enacted in 1932. If you didn't
2 file a gift tax return, there is not statute of limitations
3 of all -- in theory it goes all the way back to 1932. It
4 goes back 52 years.

5 So if the IRS is going to be consistent with what you
6 want to do, would -- is my understanding correct that you
7 would want to go back 52 years?

8 Secretary Chapoton. Senator, most of --

9 Senator Heinz. If not, why not?

10 Secretary Chapoton. Well, if the case were known -- and
11 there were, in fact, some cases -- this really just got
12 popular in the last 10 or 15 years.

13 Senator Heinz. I understand. But let's say --

14 Secretary Chapoton. In theory you are correct. In
15 theory you would go back.

16 Senator Heinz. In 1948, somebody lent somebody
17 \$5 million. They would be subject to his all the way back
18 to 1948. Right?

19 Secretary Chapoton. That's correct.

20 Senator Heinz. The only other comment I would like to
21 make, Mr. Chairman is this. As I understand the Dickman case,
22 it does not apply to the instances that Senator Long was
23 talking about; namely, the imputed rental value of a farm
24 lent to a son or a house lent to a daughter or any of those
25 kinds of loans of real property, loan with a small "l" where

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1 rent would be imputed.

2 However, I would suggest that if we go along with the
3 IRS' position we are going to be setting a precedent which is
4 that when a court comes along and rules that there is imputed
5 rent on a farm that a farmer has lent for the purpose of
6 livestock grazing to a child engaged in the cattle business,
7 when the court rules on the issue similarly of a residence
8 and so forth, that we will have set a precedent here by our
9 action today.

10 I would hope that everybody has in mind, therefore,
11 the way we decide to treat the penalties, retroactively or
12 not retroactively, ~~and no action is to allow them retroactively~~
13 to be collected, we will set a precedent on those other
14 cases, I think, should they occur.

15 Senator Chafee. Well, Mr. Chairman, the precedent we
16 are setting here as I understand it, first, is for the
17 first time we are going back and giving a blanket exemption
18 for those who were affected by a Supreme Court tax case. And
19 that is the uniqueness of the precedent.

20 Secondly, I don't understand Senator Heinz's point
21 because if he says that they might go back and claim
22 retroactivity for rentals, why wouldn't they do it in the
23 future?

24 Senator Heinz. We don't have a case yet.

25 Senator Chafee. Well, no, we are all acknowledging that

1 for the future these interest free loans will be taxable.

2 The court said it.

3 Senator Heinz. It doesn't cover rental.

4 Senator Chafee. I know it doesn't cover rentals, but
5 under your point it could just as well in the future as it
6 could in the past.

7 Senator Heinz. Right.

8 Senator Chafee. I don't understand your point.

9 Senator Heinz. Let me explain the point. The point is
10 that the issue could very well reoccur. And I just want our
11 colleagues to be on notice that if it does reoccur, and if
12 we say, yes, it's all right to look back 52 years to
13 recapture not just interest, but rent, we are going to have,
14 whether it be on farmland or anything else, a lot of
15 constituents who are interested in that question.

16 The Chairman. How many cases are we talking about?
17 Are these just the average working family in America?

18 Secretary Chapoton. No. Obviously, Senator, the value
19 of the loan has to exceed -- the interest on the loan has to
20 exceed \$3,000.00 under prior law, \$10,000.00 since 1981.

21 And then the lifetime exemption of \$30,000.00 could be
22 elected. So we are talking about larger amounts.

23 The Chairman. I was just reading an article in the
24 New York Times on Sunday. It said you could still make a
25 \$200,000.00 a year tax free if it were assumed that they

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1 could reasonably earn 10 percent on that money, a sum that
2 would rule out most middle class families.

3 I think \$200,000.00 would rule out about everybody
4 in the audience. So I think we need to determine that. I
5 don't think Treasury made a very good case. I don't know who
6 was involved. We were talking about a working couple in
7 government or --

8 Secretary Chapoton. Let's pick a case before 1981, to
9 be fair, before the exclusion was raised from \$3,000.00 to
10 \$10,000.00. The value of the loan, that is the interest
11 charged on the principal of the loan would have to exceed,
12 if maybe from a husband and wife to a child, \$6,000.00. So
13 at the 10 percent rate, the loan would have to be a cash loan
14 of more than \$60,000.00 before they would have a problem,
15 assuming that neither spouse elected the lifetime exemption
16 of \$30,000.00, which in combined total would be another
17 \$60,000.00 of interest that could be transferred tax free.

18 So we are talking about, obviously, large amounts from
19 families that can loan children sums interest free.

20 The Chairman. Well, do you have any idea how many
21 might be involved? Are you going to wait until everybody
22 dies to correct this? How are you going to go about it?

23 Secretary Chapoton. The cases would be that are now in
24 controversy, that are now in audit. They would be picked up.
25 There would be no special method of going back and getting

25

1 other cases.

2 The Chairman. How many cases are now in audit?

3 Secretary Chapoton. I would have to get that from the
4 Internal Revenue Service, Mr. Chairman.

5 The Chairman. I just don't know how big the problem
6 is. I think it would be helpful if we had that.

7 Secretary Chapoton. We can certainly provide that data.
8 And they do have data on how many cases are involved. We are
9 most concerned, of course, about the precedent affect of
10 overruling the Supreme Court.

11 The Chairman. All right.

12 Senator Matsunaga. Mr. Chairman, as I understand it, --
13 I don't have the exact provision before me -- this harsh
14 provision will not in anyway affect a public servant like
15 me who has no rich relatives to borrow money from?

16 Secretary Chapoton. It will not affect someone that
17 doesn't have at least \$60,000.00 to loan interest free. And
18 now more than \$200,000.00, as the Chairman pointed out, to
19 loan interest free.

20 The Chairman. How did you arrive at the de minimis rule?
21 I mean is there any magic in that?

22 Secretary Chapoton. No, there's not any magic in that.
23 It was a reasonable assumption.

24 Senator Long. How much would you allow for the de
25 minimis?

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1 Secretary Chapoton. The de minimis rule for the
2 future, there was an exclusion for loans of up to
3 \$10,000.00 in general, and then for a family loan up to
4 \$100,000.00, to a family member provided that the borrower
5 did not have outside investment income so that there was not
6 an intent to transfer -- it was not being abuses devised to
7 transfer wealth. We are trying to cover cases where it might
8 be a loan for a home or for a tuition, medical expenses, that
9 type of thing.

10 Senator Long. It seems to me as though it might be
11 prejudicial to those whom we expect to tax if we just exempt
12 all these de minimis cases so you then remove from the field
13 of concern 90 percent of the cases, and then you zero in on
14 the 10 percent you have left. It might be prejudicial to
15 those who are left in there to be adversely affected.

16 Mr. Brockway. Well, Senator, the Supreme Court in the
17 Dickman case fairly clearly laid out to the government that
18 they are talking about cash transfer loans being subject to
19 the gift tax, and indicate that they do not expect this to
20 apply to the normal inter-family loan for use of cars or
21 vacation cottages based on family relationship.

22 And they discussed that issue and say that they don't
23 intend to cover that in their opinion.

24 Senator Long. Mr. Brockway, has the Treasury been up
25 here asking us to pass a law to resolve this matter the way

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1 Treasury would like to resolve it?

2 Mr. Brockway. As far as I know, it was the proposal
3 last year. That was the first time the administration has
4 proposed any changes in the law in this area.

5 Senator Long. I am told that now Treasury has been
6 fighting this battle down through the years in the court,
7 undaunted by adverse decisions in tax courts and the
8 appellate courts, and if that's the case, I would have thought
9 that they would have come to us and said, look, this doesn't
10 make any sense; we think it's wrong.

11 I'm not blaming you, Mr. Chapoton. I'm just talking
12 about your predecessors. It seems to me as though they would
13 have been up here saying that we think this is wrong and
14 that it ought to be corrected and you people ought to do
15 something about it.

16 And so far as you know, that was not the case?

17 Mr. Brockway. So far as I know, there has been no
18 official -- and this has been something that was discussed
19 at the staff level off and on, I guess, since the Lester
20 Crown case was decided in 1978.

21 But the issue of how exactly you do it has been
22 complicated. And I don't think any administration has asked
23 for help.

24 Secretary Chapoton. I think not. And I do think that
25 there are some questions that ought to be litigated and

23
1 decided in the courts. As a matter of fact, one of the
2 things that concerns me is that we have the tendency to
3 correct everything by specific statutory provision and
4 then we are specifically saying that everything not covered
5 is okay.

6 But at this point we did make the proposal in this
7 year's budget. I believe that's the first time.

8 Senator Heinz. Mr. Chairman, since not a lot of revenue
9 is involved here, why don't we vote on Senator Packwood's
10 proposal?

11 The Chairman. I would just rather have some facts before
12 I vote. I'm prepared to vote. I thought there were so many
13 people that weren't.

14 Senator Packwood. I think the point that Russell raises
15 is very, in my mind, valid. Something is not necessarily
16 fair or unfair only because it happens to involve a few high
17 income taxpayers, although I apparently take it because of
18 your willingness on de minimis, there must be a lot of fairly
19 middle income taxpayers involved in this also, or the de
20 minimis rule would not be needed anyway.

21 But to say that it only applies to a few wealthy -- if
22 that's what it does -- and, therefore, there is something
23 unfair -- it just smacks to me of unfairness on its face.

24 Secretary Chapoton. Well, Senator, if I might say just
25 in defense, we say it is unfair because it is avoidance of the

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1 gift tax. That's the purpose of the transactions, and
2 that's the affect of the transactions.

3 Senator Packwood. Well, Russell very clearly says you
4 are going to extend the de minimis rule backwards. You agree
5 to that. So for all of those who should be subject to the
6 Dickman rule, you are going to exempt them because they
7 don't violate it enough to be worth pursuing, I guess. I'm
8 not quite sure what your rationale is.

9 Secretary Chapoton. To provide certainty. In most of
10 those cases, there would be no tax due in any event.

11 You provide certainty and you give effect to the case
12 language in the Dickman case that you are trying to reach
13 cases where there is a transfer of wealth and not where there
14 is a loan for a tuition.

15 Senator Long. You know, when you say that a loan to a
16 relative is purely for tax avoidance purposes, I fear that
17 you just haven't had the experience with that type of thing,
18 with which I am familiar.

19 I can bring you a lot of people -- and I'm not going to
20 get involved in my personal experience. But I can just
21 recall the names of a lot of people who have made loans to
22 relatives thinking they were going to get their money back.

23 (Laughter)

24 Senator Long. Only to be badly disappointed and not get
25 a nickel of it back.

1 The Chairman. I would suggest that you come back with
2 some facts and figures before we vote on this. And also on
3 the -- what's the score now on the luxury car? That has been
4 going up and down.

5 Mr. DeArment. Mr. Chairman, at the moment the luxury
6 car provision is passing.

7 The Chairman. It's ahead today?

8 Mr. DeArment. It's ahead today. The vote is 9 to 8.

9 Senator Packwood. Which is counted as passing?
10 Exempting them or taxing them?

11 Mr. DeArment. Taxing them is passing. The proposal is
12 passing.

13 The Chairman. And let me suggest that we have asked
14 Treasury to find a better proposal. I think I changed my
15 vote to present to indicate not that I want them to avoid
16 the tax -- and as I understand, Treasury is trying to do that.

17 Secretary Chapoton. Yes, sir. We would like a little
18 more time on that. But we would like to design a better
19 proposal to get at the personal use question, which is
20 basically the question involved here.

21 Senator Bradley. Mr. Chairman, haven't we already
22 agreed in committee to the Treasury amendment offered last
23 week that had a presumption of 50 percent?

24 The Chairman. Right.

25 Secretary Chapoton. That's correct. We would like to

1 embellish that a bit more.

2 The Chairman. We did agree to that.

3 Secretary Chapoton. And that has not been reversed
4 as I understand it. It's not involved in this vote, as I
5 understand it.

6 The Chairman. There was no controversy over that
7 vote.

8 Now there is still about four matters.

9 Senator Bradley. Mr. Chairman, and that would apply
10 not just to autos but to yachts and to --

11 Secretary Chapoton. That's correct. It would apply to
12 a broader range of assets.

13 The Chairman. Drapes, carpeting.

14 Senator Bradley. Flying carpets.

15 The Chairman. As I understand now on this list that
16 we had hoped to complete this morning, we still have
17 outstanding --

18 Mr. DeArment. Number six.

19 The Chairman. Number six.

20 Mr. DeArment. Number seven.

21 The Chairman. Number seven -- that's one that Senator
22 Moynihan wanted to be involved in.

23 Number eight -- Senator Packwood and Treasury will
24 hopefully work out by 2:30.

25 Number --

22
1 Mr. DeArment. Number ten we passed over to clear it
2 with Senator Grassley. Maybe we could take that up.

3 The Chairman. What about number ten? Senator Grassley
4 is here now.

5 Secretary Chapoton. I think, Senator Grassley, this is
6 the question. It was on the estimated tax, and I pointed out
7 earlier that you had had the concern -- we had had the
8 concern that the estimated tax penalty, there is no power
9 to abate the tax now, and we wanted some power to abate, but
10 we didn't want the power to abate to be so broad that every
11 taxpayer who would be subject to the estimated tax penalty
12 would claim a reasonable basis for not paying his estimated
13 tax, and we would simply be moving from a totally mechanical
14 penalty to one on which every taxpayer claims he shouldn't
15 have had imposed on him.

16 So that we wanted to work with you to define the
17 hardship cases where the authority to abate does exist. I
18 know there have been some discussions, but I think we need
19 to talk to your people further on that.

20 Senator Grassley. Am I right? We worked it out where
21 we are going to take the list that the House had in their
22 version, add to it aging and disabled, and have the lower
23 standard in those instances, and have the higher standard
24 in all other instances.

25 Secretary Chapoton. That's correct. I would just like

1 to just go over that language specifically, Senator. That's
2 the approach though. The list there, and the aging, and
3 the disabled. And we need to define those categories, ~~and~~
4 ~~the~~ Senator Grassley. Well, for the purpose of those
5 categories, we will take the lower standard.

6 Secretary Chapoton. Right.

7 Senator Grassley. All right. And then in all other
8 instances we will still leave it up to the Commissioner of
9 Internal Revenue for making the decision to abate ~~at a higher~~
10 standard.

11 Secretary Chapoton. Right. We want the authority to
12 abate in every case. That's right.

13 Senator Grassley. If that is what we have worked out --
14 is there still a question as to the specific --

15 Secretary Chapoton. Yes, there is. I want to look at
16 the language a little more closely.

17 Senator Grassley. All right. Then, Mr. Chairman, I
18 guess we are generally going in the same direction, but we
19 haven't gotten the finished product yet.

20 The Chairman. All right. Well, let's go ahead and
21 agree to that, and then you can check the language on it.
22 If there is some problem, then we will open it up again.

23 Senator Grassley. All right.

24 The Chairman. So that leaves us with how many open
25 issues on this list? Okay. We can vote on those this

34
1 afternoon. And then we are going to start with
2 foundations, coppers ink and lead super fund tax, if
3 Senator Baucus is here; reporting on independent contractors
4 is with Senator Boren. I think it's a technical amendment
5 in a sense. Thirty percent withholding tax on foreigners,
6 Senator Chafee.

7 Reduced excise tax on methanol. We have a list of them
8 here.

9 Senator Bradley. Mr. Chairman, is my amendment on that
10 list that you and I discussed last week and you asked me to
11 defer it until today?

12 The Chairman. No. We are still on tax issues.

13 Senator Bradley. It is a tax issue.

14 The Chairman. But it replaces a spending item, I
15 think.

16 Senator Bradley. Yes.

17 The Chairman. So it's not on this list.

18 Senator Bradley. All right. But will we be able to get
19 to that at some point?

20 The Chairman. At some point.

21 Senator Bradley. Thank you.

22 Senator Grassley. Mr. Chairman.

23 The Chairman. Senator Grassley.

24 Senator Grassley. Could I explain and also inquire?
25 I would first of all like to explain that I was absent this

1 morning because I was chairing the Subcommittee on Aging,
2 Title VI of the Older Americans Act Reauthorization.

3 Secondly, it's my understanding that while I was gone
4 that we put aside a point I wanted to bring up on
5 prepayment.

6 The Chairman. Right. Maybe you could do that now.

7 Senator Grassley. And also a point that I wanted to
8 bring up on income averaging.

9 The Chairman. All right.

10 Senator Grassley. I'm willing to do the first one. I
11 would like to leave the second one for a little while.

12 The Chairman. All right.

13 Senator Grassley. I would like to suggest to the
14 committee and have the staff write an amendment that would
15 allow no more than 50 percent of expenses incurred in the
16 current year can be prepaid. If over 50 percent, of course,
17 of the expenses are prepaid, they amendment should allow
18 deductible when they occur, and then could be carried over
19 to the following year.

20 And the reason I would like to do this is that of course
21 it does bring in an estimated revenue of \$400 million,
22 but also I feel that ordinary businessmen don't prepay over
23 50 percent of their expenses in a trade or business. And
24 it was suggested that we ought to use the active management
25 test, but I think we have run into so many problems whenever

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1 we try to apply that active management test particularly
2 to agriculture. And members will understand that I had had
3 a major concern about agriculture as this whole prepayment
4 issue has been brought up.

5 And I think the people that I wanted to protect, the
6 small business people and the farmers, have been inadequately
7 protected by the compromise that has been worked out. And yet
8 I feel that there has been an abuse that isn't taken care of
9 in the compromise. And I think the 50 percent limit in
10 any one year of writing off expenses through prepayment would
11 take care of that.

12 I want to stop abusive tax shelters and I think this
13 will do it. And I'm doing it more for this reason than the
14 fact that it brings in \$400 million. But I think the fact
15 that it brings in that makes up for some of the revenue that
16 we thought we were going to get on an original compromise
17 that didn't materialize.

18 The Chairman. I'm not certain what that would bring in.
19 Probably not \$400 million.

20 Secretary Chapoton. I would want to check the revenue
21 estimate as well. I am advised that it might go up -- that
22 it might be in that ballpark.

23 The Chairman. If Senator Boren agrees with Senator
24 Grassley on that issue, we would like to work it out. If not,
25 we will just have to vote on it this afternoon.

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1 Senator Boren. Maybe we can work it out.

2 Senator Grassley. Since it is 12:30, I would just as
3 soon as wait and work it out too.

4 The Chairman. I'm willing to wait and work it out.
5 But I understand that -- we are going to try to finish
6 everything by Thursday night. One problem is that the
7 Secretary and the Assistant Secretary plan on going to China.
8 Is that next week?

9 Secretary Chapoton. Saturday morning.

10 The Chairman. And we don't all want to go to China
11 with you so we would like to finish this package while you
12 are still here. So maybe we go all day today and all day
13 tomorrow and all day Thursday.

14 We are handing out the additional list to work on this
15 afternoon. It contains 18 matters that members have asked
16 that we bring up. Now I'm certain other members have other
17 matters. Then we have some major items that we are still --
18 the two extension or moratorium on allocation of domestic
19 research, three year extension in incremental research and
20 experimentation credit, the mortgage revenue bond, and IDB
21 matters, the so-called energy tax package, the phase-in of
22 administration spousal IRA, which Senator Grassley has a
23 direct interest in. He's one of the original sponsors, and
24 he wants to be here for that.

25 The phase-in of the administration's enterprise zone

1 proposal. That would be one zone in Kansas.

2 (Laughter)

3 The Chairman. Modification, extension of targeted
4 jobs, tax credit, and modification of highway use and diesel
5 fuel taxes.

6 I would indicate to those who are still holding out in
7 the audience that the sooner we get to your matter, the less
8 chance there is that we will raise the revenue figure. As
9 we adopt add-ons, we need to raise more revenue, and those
10 who are still holding out do so at their own risk.

11 And we will meet again at 2:30.

12 (Whereupon, at 12:30 p.m., the hearing was recessed.)
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AFTERNOON SESSION

(2:43 p.m.)

1
2
3 The Chairman. We are going to have a quorum, aren't we,
4 since we had one this morning. There are one, two, three,
5 four, five. All right. Let's move very quickly to
6 foundations. Senator Durenberger is here.

7 That was the first item on the new agenda. We still
8 have five items above it left over from this morning. Dave,
9 do you want to be heard?

10 Senator Durenberger. About foundations? I would be
11 glad to.

12 The Chairman. All right.

13 Senator Durenberger. I will briefly describe the
14 recommendations, all of which are incorporated into S. 1857,
15 which has seven co-sponsors on this committee and another
16 seven of our colleagues.

17 Section I -- and we had a hearing on this bill a couple
18 of weeks ago in subcommittee -- would eliminate the
19 discriminatory treatment of lifetime gifts to private and
20 nonoperating foundations by making gifts to foundations
21 deductible on the same basis as gifts to public charities
22 and private operating foundations.

23 I won't lay that out. I think we all know what that is,
24 but in other words, there would be equitable treatment of
25 the basis for the gift as between nonoperating foundations

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1 and public charities.

2 Second, Section II provides a substantial contributor's
3 lineal descendants except for children and grandchildren, who
4 would not be considered as disqualified persons for reasons
5 of restrictions and excise taxes that are imposed on dealings
6 between the foundations and disqualified persons.

7 I think that is fairly similar to what the House has.
8 Maybe they took another step in the generation, but it is
9 trying to get some realism into who in the family is a
10 disqualified person.

11 Section III exempts private foundations from detailed
12 expenditure responsibility requirements if the total grants
13 by a private foundation or related foundations to a grantee
14 to a taxable year do not exceed \$25,000.

15 Section IV grants the Secretary of Treasury authority
16 to abate first-level penalty taxes, in which case he
17 determines the violation of the private foundation rules as
18 due to good faith, error, or omission, and was corrected
19 within the statutory period. This is to give some guidance
20 to the Secretary in the levying of penalties.

21 Section V allows foundations making grants to rely on
22 official IRS rulings which recognize the public charity or
23 operating foundation status of a potential grantee.

24 Mr. Chairman, those are the five main elements of S.
25 1857 which I would move be part of this bill, together with

1 four provisions from the House bill. One is public disclosure
2 and accessibility of information on foundations to grant
3 applicants. That is Section 307(c) of H.R. 4170, and Code
4 Section 6104(d), which requires the IRS to more strictly
5 enforce the reporting laws and requires that the annual
6 notice relating to public inspections be amended to include
7 the phone number of the foundation's principal office.

8 That is for accessibility to the foundations by
9 potential beneficiaries.

10 Second, in the House bill amendments, the excess
11 business holdings rules. Section 308, 311, and Section
12 318 (b) of H.R. 4170 and Code Section 4943, giving the
13 Secretary of Treasury authority to grant a five-year
14 extension for the disposition of certain excess holdings.

15 Then, the third provision is an exception to the self
16 dealing rules for certain stock transactions. This is in
17 Section 313 of H.R. 4170 and covered in the Code in Section
18 4941. It provides relief from self-dealing penalties
19 resulting from an arms' length stock sale transaction at
20 fair market value which was included in the House bill.

21 And finally, determination of status of a substantial
22 contributor which is Section 314 of H.R. 4170 covered in
23 the Code in Section 507(b), which provides that an individual
24 may cease to be a substantial contributor and thus a
25 disqualified person under certain circumstances which the

1 individual has neither made gifts nor served on the board
2 of any foundation during the preceding ten years and is
3 no longer the foundation's principal donor.

4 Mr. Chairman, that concludes my explanation of the bill.

5 The Chairman. I think Treasury may have a difference
6 of view in some areas. Maybe we can hear from them.

7 Mr. Chapoton. Yes. Mr. Chairman and Senator
8 Durenberger, we went over these issues in depth in our
9 testimony before this committee and, of course, in the
10 development of H.R. 4170.

11 We are supportive of the changes in H.R. 4170, but we
12 would prefer not to go further than those provisions, most
13 specifically the enlarging of permissible gifts to private
14 foundations which is done partially in H.R. 4170 and, as I
15 understand, Senator Durenberger would in effect equalize
16 private gifts to private foundations and gifts to public
17 charities.

18 I think that is the foundation community's principal
19 interest, and I think that is our principal concern in all
20 candor. We think there should be a difference maintained
21 -- a greater benefit provided for gifts to public charities
22 and private foundations -- for the simple reason that funds
23 that are given to public charities flow immediately into the
24 public stream -- into the charitable stream -- that is
25 certainly not always the case with respect to gifts to

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1 private foundations. What is required is a pay-out with
2 respect to that gift in the future, and the point has been
3 made that private foundations have suffered and fewer have
4 been created, and existing ones have declined in number, and
5 existing foundations have been terminated.

6 We have really not been able to support that assertion,
7 and perhaps it is somewhat beside the point. There is no
8 doubt that the private foundation community is well. No
9 doubt they would like to be better off with increased limits,
10 but we just think it makes very good policy sense to stick
11 with the decision that has been in the law, basically, since
12 1954 that there should be a distinction in gifts between
13 private foundations and public charities.

14 Senator Durenberger. Now, Mr. Chairman, this is a
15 difference of view on how best to move charitable giving
16 to the donees. As far as we could tell at the hearing, no
17 one except Treasury shares this particular view. Both the
18 foundations and the public charities that the Secretary would
19 seek to benefit took the position that this particular
20 change ought to be enacted -- that they both ought to be
21 treated the same. And I think that is probably because the
22 charities put a large value on the contributions that come
23 from --

24 The Chairman. Is that the only difference?

25 Mr. Chapoton. No, there are other differences. I think

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1 that is the principal difference. We would have to go back
2 over it, and I didn't have a listing of your changes.

3 The Chairman. We need to make some decisions. I want
4 Treasury at least to have a chance to review in detail.
5 Is there somebody who could be reviewing that while we go
6 onto something else?

7 Mr. Chapoton. We have reviewed it.

8 The Chairman. I don't want to put it off until
9 tomorrow. I would like to finish it today. If we put
10 anything off until tomorrow, you will be gone.

11 Mr. Chapoton. We could go down these, one by one,
12 today. I mean, there are only four or five.

13 Senator Durenberger. Why don't we just vote on it?

14 The Chairman. I don't want to vote on it until we
15 find out the objections to see if they have any validity.
16 I think Senator Pryor has something in this package, too.

17 Since there are only four, let's go down the four right
18 now.

19 Mr. Chapoton. Would you just mention them to me again?

20 Senator Durenberger. The second one is where you cut
21 off the disqualified persons among lineal descendents.
22 This definition is a substantial contributor's lineal
23 descendents except for children and grandchildren.

24 Mr. Chapoton. Senator, I think we can reach agreement
25 on that. I think the whole purpose is to not have to keep

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1 tracing too long those who are disqualified persons.

2 Senator Durenberger. The next one is the exemption of
3 private foundations from detailed expenditure responsibility
4 requirements of total grants by a foundation -- not to exceed
5 \$25,000.

6 Mr. Chapoton. The \$25,000 came up on the other side,
7 and the expenditure responsibility rules simply require that
8 there be a pregrant inquiry, that there be a report from
9 the foundation's recipient of the gift, and that there be
10 a filing with the Internal Revenue Service.

11 We have attempted -- we have asked for specific
12 recommendations to streamline those procedures, but we think
13 it would be a terrible mistake to simply exempt gifts from
14 that type of responsibility when indeed it would seem that
15 any foundation making a gift would -- or any charity making
16 a gift -- follow those basic rules.

17 So, we have yet to understand what the specific concern
18 with the existing law is -- or the existing regulations.
19 I think if we could find out what the problems are, we could
20 do it in the regulations.

21 Senator Durenberger. Let me set that one aside for now.
22 The fourth one is the authority of the Secretary to abate
23 first-level penalty taxes in cases in which he determines
24 that the violation of the private foundation rules was due
25 to a good-faith error or omission and was corrected within

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1 the statutory period.

2 Senator Chafee. Senator, are you working from some
3 sheet here? I can't find that.

4 Senator Durenberger. I am working from some notes
5 that are in front of me.

6 Ms. Moran. Senator Chafee, those foundation proposals
7 that are in front of you are not the Durenberger bill.
8 There has been a staff proposal and a description of 4170.
9 So, if you are looking at the other proposals here, that is
10 not what Senator Durenberger is reading from.

11 Senator Chafee. This is going so fast that I can't
12 understand what the Durenberger proposals are. Are they on
13 this Durenberger-- Here is a sheet -- Durenberger foundation
14 proposal?

15 The Chairman. Has it got a staple in the upper left-hand
16 corner? I think you have it right there.

17 Senator Durenberger. We are on Section IV -- down there
18 at the bottom.

19 Senator Chafee. Go ahead.

20 Mrs. Chapoton. This is the ability to abate the
21 first-tier penalty where there is a showing-- There is a
22 three-tier penalty tax on violations of the private
23 foundation rules enacted in 1969. This would abate the
24 first-tier penalty where the showing is due to reasonable
25 cause. This sort of gets back to the thing that we have

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1 worried about some this morning -- that you can always or
2 you can often have a showing of reasonable cause, though
3 I think in specific situations, difficulty with complying
4 with the rules could possibly be shown, in which event the
5 penalties might not be applied.

6 I am just reluctant to have a reasonable cause penalty
7 for a set of penalties that was supposed to be hard and
8 fast rules and to discourage very specific types of conduct.

9 I don't have a solution on a middle ground, and so
10 until we come up with one, I would be reluctant to go along
11 with this, Senator.

12 Senator Durenberger. Then, the fifth one was allowing
13 foundations making grants to rely on official IRS rulings.

14 Mr. Chapoton. Yes. We can definitely-- We did
15 something of that in 4170, and if there are still problems
16 with that, we can definitely work something out there.

17 The Chairman. Could I ask? Which one has the five
18 items on it? Which sheet?

19 Ms. Moran. The one labeled Durenberger Foundation
20 Proposal.

21 The Chairman. That is his proposal. I thought Treasury
22 had five.

23 Mr. Chapoton. No, I was just responding to Senator
24 Durenberger.

25 The Chairman. Okay. Where are we?

1 Mr. Chapoton. It seems to me that, if I could work with
2 Senator Durenberger on two of them. The principal issue on
3 which we disagree is eradicating the difference in treatment
4 to donors whether they make a gift to a private foundation
5 or a public charity.

6 Senator Durenberger. Buck, from my standpoint, three
7 and four -- the House language would be okay. You already
8 agreed that you would go with two and five on my list.
9 Three and four I will give into you.

10 The chairman. And then one you will work out?

11 Senator Durenberger. I don't know if one will work out.
12 We may have to vote on one. They just take the position
13 that there ought to be a distinction between foundations
14 and charities.

15 Mr. Chapoton. In the House bill, there was an increase
16 in the limit on gifts to private foundations, and so we did
17 go part way on the House bill, but yes, there is a basic
18 disagreement because you would eradicate the --

19 Senator Durenberger. And I am assuming we will end up
20 somewhere in between when we get to conference.

21 Senator Chafee. I wonder if Mr. Chapoton would briefly
22 tell us why Treasury sees the difference between the
23 foundations and the charities.

24 Mr. Chapoton. Yes. I think it is quite basic, that is,
25 a gift to a private foundation. Number one, I think you can

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1 start this with the pre-1969 days when there were significant
2 abuses involved in management and control of private
3 foundations.

4 Full charitable deductions for gifts to a private
5 foundation -- then the foundation could hold those assets
6 perhaps in controlling a business -- that type of thing that
7 we tried to fix in 1969 and did fix for the most part in
8 1969.

9 But one of the fixes was to require a pay-out of a
10 certain percentage of the foundation's assets into public
11 charity. So, the principal does not go immediately into the
12 charitable stream, but a rather low percentage of that
13 principal does each year, as contrasted with the case where
14 it is given to a public charity and the full amount is
15 utilized immediately in the charitable stream.

16 Now, it may go into an endowment fund or for college,
17 but that strengthens that college's position in every sense
18 and that endowment fund is being used directly in the
19 charitable stream as contrasted with the private foundation
20 except there is no use other than the required percentage
21 pay-out per year, and that is deferred a year in each case.

22 The Chairman. All right. So, as I understand it,
23 there is essentially agreement on four points. One point is
24 open. Right? Number one?

25 Mr. Chapoton. We went over the essential agreement

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1 rather rapidly with the possibility of raising it with
2 Senator Durenberger again. I thought that would be fine.

3 Let me see if we have something. Number four
4 particularly bothers me -- the abatement -- but --

5 Senator Durenberger. I said I gave in on three and
6 four, and you gave me --

7 (Laughter)

8 The Chairman. You took the House provision.

9 Mr. Chapoton. We are signed off on the House floor.

10 The Chairman. So, you are ready to agree on two and
11 five, and he agrees on three and four, and one we will vote
12 on?

13 Mr. Chapoton. Okay.

14 The Chairman. Are we ready to vote? Would the clerk
15 please call the roll?

16 Senator Moynihan. Mr. Chairman, could I just make a
17 brief comment?

18 The Chairman. Yes.

19 Senator Moynihan. Just to be clear. The provisions we
20 have agreed on, Mr. Secretary, there are two New York State
21 foundations whose situations would be remedied by the House
22 provision. Those are the Strong Museum in Rochester and
23 then the Altmann Foundation in New York City. The latter
24 would give them five final years to dispose of the stock.
25 And in the case of the Rochester Strong Museum, it would

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1 provide up to 2 percent excise tax, and they would not be
2 subject to it so long as the board and officers are members
3 of the public and no more than 25 percent of the board are
4 family members related to the foundation's founders.

5 And the House provisions take care of these two
6 institutions. Do I understand that we have agreed to those?

7 Mr. Chapoton. Senator Durenberger has not raised those
8 provisions. We had concerns about the latter one. I would
9 have to refresh myself on the first one.

10 Ms. Moran. Senator Moynihan?

11 Senator Moynihan. Yes?

12 Ms. Moran. The other proposal with respect to excess
13 business would be a separate proposal, other than Senator
14 Durenberger's proposal. That would take care of all. The
15 Strong Museum is in the House bill, as you know, and that
16 would not be taken care of with our separate excess business
17 proposal.

18 So, Altmann would be taken care of. Strong would not
19 if we did not do the whole House bill.

20 Senator Moynihan. Then, can I offer a proposal on that
21 particular one? When the time comes?

22 The Chairman. When the time comes. First, I would
23 like to recognize Senator Pryor who needs to leave here
24 momentarily and wants to raise a technical point. Buck,
25 could you listen to Senator Pryor?

1 Mr. Chapoton. Yes.

2 Senator Pryor. Mr. Chairman, this amendment that I do
3 have and I would like to raise at this point is to encourage
4 employee stock ownership of stock and this amendment would
5 permit the ESOP plan to require more than 20 percent of
6 the stock of the corporation. When there is a foundation
7 involved and the corporation has previously been classified,
8 I guess you would call it, as a substantial contributor to
9 the foundation, it would apply only to those pre-1969
10 foundations.

11 Frankly, I know of only one foundation in the country
12 that this would affect. There may be more, but I don't know.
13 But it would not deal with the self-dealing provisions but
14 would amend the excess business holdings provision. And I
15 think it speaks to equity and it certainly speaks to
16 encourage employee stock ownership in these areas.

17 And I would just like to raise this at this point.

18 The Chairman. Why don't we just adopt it? Treasury,
19 do you have a problem with that?

20 Mr. Chapoton. Mr. Chairman, I think we do have a
21 problem with that. What you are really saying is the fact
22 that there is a control -- compelling interest -- I am having
23 trouble understanding why ESOP should be treated better than
24 other stockholders that control a company that is a
25 substantial contributor.

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1 The Chairman. Why don't we do this then? Since Senator
2 Pryor has another engagement, why not have someone address
3 that with Treasury. Do you have a staff person here?

4 Mr. Chapoton. Yes, Mr. Courtway is here.

5 Ms. Moran. Senator Dole? I have talked with Tom and
6 I have talked with the people who represent the Reynolds
7 Foundation -- that is the one you are interested in, and
8 we have proposed a more limited rule that would hopefully
9 just apply to their transaction and not allow a broad
10 generic exception like your bill does.

11 I have talked to Treasury about it and, while they have
12 general reservations, I believe about the whole exemptions
13 from the excess business holdings, I think they would
14 probably prefer this to the other bill.

15 Mr. Chapoton. Yes.

16 The Chairman. If you prefer that, let's adopt it.

17 Senator Bradley. Mr. Chairman?

18 The Chairman. Just a moment. Is that all right with
19 you, Dave?

20 Senator Pryor. I am not sure what happened to me.

21 I am not quite sure what you are talking about here.

22 (Laughter)

23 The Chairman. We just accepted your amendment that
24 would apply to your foundations.

25 Ms. Moran. Senator, it is referenced in this document

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1 called "Private Foundation Excess Business Holdings." If
2 you do have problems with it, just let me know.

3 Senator Pryor. Is that Section E in that paper?

4 Ms. Moran. Section E, last sentence.

5 Senator Pryor. All right.

6 The Chairman. We will check with Senator Pryor if
7 that doesn't satisfy him.

8 I wonder if we might go back to the general proposition
9 because I know a number of members have specific amendments
10 to raise on specific foundations, but, Dave, would you
11 restate for the benefit of a couple who just came in your
12 view on number one?

13 And then I will have Buck address it briefly, and then
14 we will vote.

15 Senator Durenberger. Yes. Section I would eliminate
16 the current distinction between the treatment of lifetime
17 gifts to private nonoperating foundations and treatment of
18 the same gifts to public charities and private operating
19 foundations. So, in effect, gifts of cash and ordinary
20 income property would be deductible up to 50 percent of the
21 donor's adjusted gross income to both. Gifts of capital
22 gain property -- 30 percent of the donor's adjusted gross
23 income at the full market value for both.

24 Carryover provision -- allow a five-year carryover to
25 the extent the contribution exceeds the allowable limit for

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1 both. Treat the charities and foundations the same.

2 Senator Chafee. Could I ask Treasury -- does this
3 provision alone -- setting aside the others that you have
4 adopted or rejected of Senator Durenberger's proposal --
5 what does this do revenue-wise?

6 Mr. Chapoton. Let me get that brief.

7 The Chairman. We do lose revenue on the overall
8 proposal.

9 Mr. Chapoton. It is quite minor. It is under \$5
10 million a year.

11 The Chairman. All right. Let's vote. The clerk will
12 call the roll.

13 Senator Bradley. Mr. Chairman, before we vote on this,
14 I would like to just clarify with Buck that the public
15 charities do support this. Is that not correct?

16 Mr. Chapoton. It is hard to get the public charity
17 position on this. I understand from what Senator
18 Durenberger said that those who testified testified in favor
19 of it. I think it has clearly got to switch some giving
20 from public charities to private foundations.

21 And let me add one thing. I think, if fully informed,
22 I am not sure that those would be so affected would support
23 it. Also, I do want to point out that we are talking about
24 gifts of appreciated property which heretofore has not been
25 allowed a full deduction to private foundations so that land

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1 and other property that would be given raises the valuation
2 questions we discussed this morning. Private foundations
3 would be allowed whereas now such gifts are allowed with
4 a full deduction only in the case of public charities.

5 Senator Bradley. Mr. Chairman, if I could, I would
6 like to cite the American Bar Association section on taxation
7 in a recent testimony made it very clear that their view
8 was that this would result, if we didn't pass this, in
9 simply less gifts going to private foundations, and it
10 wouldn't mean more gifts going to public charities.

11 In fact, what people would do is not give at all, and
12 so I think that if we want to encourage charitable giving,
13 that we want to support the Durenberger proposal, which
14 would equalize the treatment of private and public
15 foundations.

16 And I think that to vote against this -- believing that
17 somehow or another you will have more money going to public
18 charities -- I think is an erroneous assumption, and the ABA
19 Tax Section has said essentially that.

20 Senator Moynihan. Could I make a point, Mr. Chairman?
21 Since the 1969 legislation, there has been a very sharp
22 drop-off in the establishment of new foundations and in
23 the monies given to existing foundations.

24 The Chairman. I think we understand it well enough,
25 but probably not, but we will vote anyway.

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

1 Senator Matsunaga. Aye.

2 Mr. DeArment. Mr. Moynihan.

3 Senator Moynihan. Aye.

4 Mr. DeArment. Mr. Baucus?

5 Senator Baucus. Aye.

6 Mr. DeArment. Mr. Boren?

7 Senator Boren. (No response)

8 Mr. DeArment. Mr. Bradley?

9 Senator Bradley. Aye.

10 Mr. DeArment. Mr. Mitchell?

11 Senator Mitchell. (No response)

12 Mr. DeArment. Mr. Pryor?

13 Senator Pryor. (No response)

14 Mr. DeArment. Mr. Chairman?

15 The Chairman. Aye.

16 On this vote, the ayes are 11, and the nays are zero.

17 And others may be recorded.

18 Now, as I understand it, we still need to address some
19 of these specific concerns. I know there is one -- Texas
20 and the MacArthur Foundation, New York. Is that true?

21 Ms. Moran. Yes.

22 The Chairman. Do you want to --

23 Ms. Moran. Senator, if I can just direct your attention
24 to the sheet that is marked Private Foundation Excess
25 Business Holdings.

1 The Chairman. Right.

2 Ms. Moran. Since November when this issue was raised
3 with us, we discussed -- I have discussed and Treasury
4 has discussed with various staff members -- the problems of
5 some of the foundations that have been brought to our
6 attention.

7 We drafted a proposed rule that is described to take
8 care of these foundations. The proposals are in front of
9 you. What I will do now is briefly list the foundations --

10 The Chairman. No, wait. If we adopt this, does that
11 eliminate the necessity for action on some of the others?

12 Ms. Moran. Yes, sir. Yes, sir.

13 The Chairman. Does Treasury support this proposed
14 change on excessive business holdings?

15 Mr. Chapoton. No, sir, we have opposed changes in the
16 current law rules on excess business holdings. We have
17 supported basically the 1969 provisions on that with
18 discretion to the service granted for the five-year extension
19 in limited circumstances.

20 The Chairman. In other words, you would rather go with
21 the one-by-one approach than make some broad change?

22 Mr. Chapoton. No, we would not even like the one-by-one.
23 The only broad change we would make though -- and it would
24 be a broad change -- it would just say five years where there
25 are unusual circumstances, but in all candor, that would

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1 almost always -- I guess it would always apply -- to new
2 gifts to foundations. It would not take care of any of the
3 previous pre-1969 gifts, which I think are of major concern
4 to some of the members here.

5 Senator Bentsen. Mr. Chairman, it is obvious from
6 this generic approach to it that some very severe limitations
7 are being put on the foundation's governing board. And I
8 think with those kind of limitations placed on it, that you
9 are justified in having this kind of an approach carried out.

10 And I think it takes care of many of these individual
11 ones that we have talked about in this committee before,
12 if those foundations are willing to measure up to this kind
13 of a test.

14 The Chairman. Maybe we have Ann discuss it briefly and
15 give us some information on who has been involved in the
16 discussion, so we understand how broad the application is.

17 Ms. Moran. Yes, sir. What we did in November and
18 December is that I discussed with staff members and also
19 with the foundations themselves -- El Palmar, Kellogg, the
20 Eustiv Endowment. Staff members who were representing the
21 interests of public welfare foundations -- the Sands Spring
22 Home and the Navy Foundation.

23 Basically, those foundations are taken care of in Item
24 B of our proposal which basically requires the foundations
25 to show some independence between the foundation and the

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1 company.

2 Senator Bentsen. A very substantial amount of
3 independence. Now, why don't you go down and show what
4 they have to do to qualify?

5 Ms. Moran. I will be glad to, sir. Basically, these
6 foundations have to -- by the time they reach the statutory
7 period under which they have to dispose of their excess
8 business holdings -- they have to either change or make
9 sure that their board of directors do not consist of more
10 than 25 percent of officers, directors, or employees of
11 the business enterprise that the foundation owns or controls
12 to a substantial extent. In addition, the business
13 enterprise itself cannot consist of more than 25 percent
14 of officers, trustees, or directors of the foundations.

15 A disqualified person -- and that generally is a
16 substantial contributor or their family -- cannot receive
17 compensation from both the foundation and from both the
18 excess business holdings.

19 Finally, none of the foundations, the officers, or their
20 directors or trustees can be a disqualified person, that is,
21 a substantial contributor or family, except if they are a
22 foundation manager, of course, they would meet the statutory
23 definition of disqualified person, but that would not count.

24 Finally, we required the foundations to continue to
25 meet the pay-out standards that are set under present law so

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1 that basically their assets have to at least produce enough
2 income to make sure that the foundations are paying the
3 statutorily required amount to charities or their charitable
4 purposes.

5 And we do say that the foundation can't acquire any
6 more excess business holdings if they are going to meet this
7 rule.

8 That takes care, we hope, of some of the foundations
9 -- that is, all the foundations here that the Senators have
10 raised to us. Some of these foundations may have to go to
11 a little effort to expand their boards or do something of
12 that nature, but basically we hope that this will keep them
13 independent.

14 Senator Bradley. It does take care of the MacArthur
15 Foundation problem?

16 Ms. Moran. Senator Bradley, yes. Proposal A takes
17 care of MacArthur.

18 The Chairman. Now, as I understand it, does Treasury
19 agree with A?

20 Mr. Chapoton. Yes, we do agree with A.

21 The Chairman. In other words, there is no objection
22 to that?

23 Mr. Chapoton. No objection.

24 The Chairman. Does everybody agree to that?

25 It is the B, C, D, and --

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1 Mr. Chapoton. It is B.

2 Ms. Moran. Yes, it is B.

3 Mr. Chapoton. That Ann has just discussed.

4 The Chairman. Has Treasury determined how many
5 foundations that might affect? Or maybe Ann knows?

6 Ms. Moran. I don't know how many B would affect. It
7 affects, of course, only those who have pre-1969 holdings.
8 It is not effective for the future.

9 The Chairman. All right. Now, would that take care
10 of MacArthur and the South Carolina? You know, we generally
11 have Broadmoor --

12 Ms. Moran. MacArthur is taken care of in A. Those
13 are post-1969 holdings and MacArthur will eventually have
14 to dispose of those holdings, but we give them an extra
15 five years.

16 The ones in South Carolina -- I think that is Sand
17 Springs -- that is taken care of in B.

18 Senator Bentsen. Mr. Chairman, it takes care of them
19 only if they are willing to restructure the board of the
20 business and the foundation and the question of compensation
21 to meet each of those requirements.

22 Ms. Moran. Yes, sir.

23 Senator Bentsen. Or it does not take care of them.

24 The Chairman. That is Watt's job.

25 Senator Matsunaga. Did I understand you to say that the

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1 Kellogg Foundation is provided for?

2 Ms. Moran. Yes, sir. The Kellogg Foundation may have
3 to, as Senator Bentsen pointed out, make some changes, but
4 if they make those changes, they will be provided for.

5 The Chairman. What about the one Senator Armstrong
6 generally raises?

7 Ms. Moran. Yes, sir. El Palmar. Yes. And Broadmoor.

8 The Chairman. And Senator Dodd generally raises one.

9 Ms. Moran. Oh, New England Day Trust, sir? That is
10 taken care of in E, Other Provisions.

11 They needed something in addition.

12 The Chairman. It takes care of one of the two raised
13 by Senator Moynihan. Is that correct?

14 Ms. Moran. Yes, sir.

15 Senator Moynihan. Mr. Chairman, when we discussed this
16 last November, I thought we had agreed that we would take
17 care of the Strong Museum in Rochester and that would be
18 done simply by adopting in our language the language of
19 Section 303 of the bill that is passed Ways and Means.
20 That is H.R. 4170. I mean, could we agree on that?

21 Ms. Moran. Senator Moynihan, as I understand it, that
22 is not an excess business holdings provision.

23 Senator Moynihan. Sorry?

24 Ms. Moran. That is not an excess business. They want
25 an exemption from their tax on the investment income.

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1 Is that correct?

2 Senator Moynihan. That is right.

3 Ms. Moran. That was a proposal in the House bill, and
4 in November we were considering doing the House bill, but
5 this provision just deals with excess business holdings.

6 Mr. Chapoton. I am just cold on this one. I think it
7 has been suggested that we said it was okay last fall, and
8 let me verify that. If we did, there would be no new
9 information on that. We would certainly have the same
10 position.

11 Senator Moynihan. Mr. Chairman, Secretary Chapoton
12 said he recalls -- as I recall -- that Treasury said that
13 this would be agreeable to them.

14 Mr. Chapoton. No, I said I believe your staff indicated
15 that we did last fall. I just don't have anything --

16 Senator Moynihan. You will find that out.

17 Mr. Chapoton. Well, if we did, we would have no
18 reason to change our position.

19 Senator Moynihan. We can put that over then until you
20 find out. Is that it?

21 The Chairman. Now, what about the other provisions?
22 Treasury has proposed C, D, and E. Is it just B that you
23 are opposed to?

24 Ms. Moran. C, I think, is in the House bill. That is
25 the downward ratchet rule.

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1 Mr. Chapoton. C and D are agreeable, Mr. Chairman.

2 The Chairman. E -- Other Provisions -- I assume that--

3 So, we will just vote on B as soon as we find out about E.

4 (Pause)

5 Senator Bradley. Mr. Chairman, where is the document
6 that we have now?

7 The Chairman. It is called Excess Business Holdings,
8 Private Foundations. I think we all have a copy.

9 Mr. Chapoton. Mr. Chairman, a part of what is in E
10 was Senator Pryor's which has just been done, and the other
11 is something we have not seen before.

12 The Chairman. Okay. So, we could agree to-- Which is
13 the one that you haven't seen -- the Donald Reynolds
14 Foundation? Is that it?

15 Mr. Chapoton. No, the first one. The split interest
16 trust -- the New London Day Trust.

17 The Chairman. All right. Let's just eliminate E from
18 that provision. We have adopted Senator Pryor's provision.
19 And then we will vote on B.

20 I know Treasury is opposed to B, but I think we need to
21 move along here.

22 Mr. Chapoton. Yes, I understand. Our concern -- and
23 I will just state it very briefly, Mr. Chairman -- is that
24 these are pre-1969 gifts. The law was clear in 1969. Most
25 foundations that had excess business holdings in 1969 have

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1 complied with the law.

2 These would add some restrictions, but frankly none
3 interlocutory directors don't go to the basic question of
4 whether the foundation can be operated and maintain
5 substantial business holdings.

6 The Chairman. Is our staff or Joint Committee satisfied
7 that we are proposing rather stringent restrictions?

8 Ms. Moran. Senator, I think the restrictions are as
9 stringent as they can be to accommodate the needs of the
10 foundations that we have discussed.

11 I think that they will provide some limitation on the
12 ability of a foundation to manipulate businesses that it
13 owns or controls.

14 The Chairman. Now, I want to ask one further question
15 from-- If we went to conference with B, would specific
16 foundations be within the scope of the conference?

17 Mr. DeArment. Every foundation that is covered by B
18 would be in the scope of conference.

19 The Chairman. All right.

20 Mr. DeArment. Scope is not our problem. It is a House
21 problem.

22 The Chairman. They have always had a problem with
23 foundations. I just wondered what happened in conference
24 if there wasn't any problem.

25 The House normally objects to any specific request on a

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1 foundation. I thought maybe B might take care of that
2 objection.

3 Ms. Moran. Something similar to B was proposed in
4 the House. We have tried to strengthen it a little more.
5 It was proposed in the House and was not taken. We tried
6 to strengthen it a little more in hopes that it would be
7 accepted by the House.

8 The Chairman. Do you want to vote on B, or is Treasury
9 ready? Without objection, we will then agree to B unless
10 somebody wants a roll call.

11 (No response)

12 The Chairman. All right. What is left on the
13 foundation? The one that Senator Moynihan will be addressing
14 by Treasury. Senator Durenberger?

15 Senator Durenberger. Yes. I just wanted to make sure
16 that Ann included Section 307(c), 313, and 314 from the
17 House bill which I had mentioned earlier.

18 Ms. Moran. I have talked to Sally about that. I
19 understand those. Yes.

20 The Chairman. Anything else?

21 Mr. Chapoton. Mr. Chairman, I have now looked at E
22 -- the first part of E -- more closely, and I think we
23 would have strong-- It would simply exempt this trust
24 -- the trust that is treated as a foundation from the
25 pay-out rules -- even on these exceptions you are discussing

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1 in B, you don't exempt them from the pay-out rule, so we
2 would have strong objections to it.

3 The Chairman. All right. Let's just set that aside
4 for the time being.

5 What about VEBAs? Have we gotten any closer on VEBAs?

6 Senator Packwood. I think we may be in agreement on
7 VEBAs that have recipients who are highly paid in putting
8 in nondiscrimination rules. I don't know if we are any
9 further on agreement with the rest of it or not.

10 The Chairman. All right. Foundations was the first
11 item on the agenda, and we have completed that. Senator
12 Baucus is not here. He will be back to discuss copper,
13 zinc, and lead superfund tax.

14 Number eight is Senator Boren's provision -- reporting
15 on independent contractors. Is that a technical matter?

16 Senator Boren. Mr. Chairman, it may be that this is
17 a matter that can be resolved by regulation. Buck might be
18 able to respond to that, but under the backup withholding
19 rules, we are receiving a mass of mail from our State of
20 concern about this question of \$600.00 worth of business
21 a year or more -- of businesses having to report the taxpayer
22 ID number and so on.

23 One of those impacted was the small newspapers, some
24 of whom are not incorporated, and for example, since
25 advertising is deemed to be a service, everybody that buys

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1 more than \$600.00 worth of advertising in a year's time,
2 that newspaper has to send their taxpayer ID number back.
3 Those doing the advertising have to file an informational
4 return subject to all the penalties and the rest of it.
5 That is just one example.

6 And I just wonder if there is any way -- we have heard
7 more from newspapers, I suppose, than any other group that
8 is being impacted this way. They are concerned about it.
9 We have heard from some other small businesses, wanting to
10 make sure that if they are incorporated, that they wouldn't
11 have to be making these reports.

12 It is my understanding that the regulations have not
13 yet been issued. Is that correct?

14 The Chairman. Have you worked that out, Buck?

15 Mr. Chapoton. I think we just have to work it out.
16 You could certainly work it out to take care of newspapers,
17 and I guess one could easily say that newspapers are not
18 the primary concern. But I think we have to recognize that
19 the minute the fact that compliance is low -- we worried
20 about that a lot in 1982 -- we didn't want to enact
21 withholding, so we enacted more stringent information
22 reporting provisions.

23 And we know that in the service industry in relatively
24 small amounts is where noncompliance is a major problem.

25 So, if we undercut that in any significant way, we are

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1 undercutting a very significant problem. We did think we
2 could clarify that the penalty of perjury requirement would
3 not apply, and that, of course, would require a piece of
4 paper being passed back and forth.

5 We are satisfied if, indeed, the requirement is there
6 that the number be reported. Now, I am not sure that meets
7 Senator Boren's principal concern.

8 Senator Boren. Are you talking about small businesses
9 in general or with newspapers?

10 Mr. Chapoton. Small business in general. Of course,
11 in small business, if you look at the noncompliance data
12 that we have submitted to this committee, nonforeign small
13 business is the principal area of noncompliance.

14 Senator Boren. Are farms exempt from this?

15 Mr. Chapoton. No, farms are not exempt, but they are
16 simply categorized differently in the data.

17 Senator Boren. I think if we put a limitation by
18 regulation on the perjury -- on that aspect -- that would
19 solve some of it. Maybe we could exempt newspapers from it
20 because they are regulated in so many other ways that I
21 would doubt that you would have very much noncompliance with
22 them.

23 Mr. Chapoton. I have no knowledge of noncompliance
24 with newspapers. I agree with that. I don't know how we
25 could --

1 The Chairman. Why don't we do this? Why don't we
2 pass --

3 Mr. Chapoton. Perhaps we could pass a technical
4 amendment exempting them from that ID number requirement
5 because it really does cause a tremendous problem with
6 them -- a lot of the small newspapers.

7 I am afraid though, Senator, that we will hear from
8 other categories of business -- small business--- which
9 will surely make the same claim, and I don't know what our
10 basis for distinguishing them would be.

11 The Chairman. Let's see if we can find some resolution.
12 If not we will just have to vote on it.

13 Mr. Chapoton. Okay.

14 The Chairman. But I do think the independent
15 contractors were quite pleased with what we did generally.

16 Mr. Chapoton. I thought so in 1982.

17 The Chairman. But we didn't do much.

18 Mr. Chapoton. If this was the only thing we did do,
19 I think it would --

20 Senator Boren. We have heard from practically every
21 newspaper in our State, that we have to send the number back
22 to virtually every advertiser because they are purchasing
23 a service, and many of these people are not incorporated.

24 Mr. Chapoton. I understand. We just have to face the
25 problem if we want to deal with compliance or noncompliance.

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1 by more information, there is going to be some additional
2 burden on those who must report the information.

3 As I said, we would be happy to take the penalties of
4 perjury part of it out so that a piece of paper doesn't
5 have to flow between the two. So, then all the newspaper
6 would have to do is supply the phone or when it sends it
7 bill or however it wants to do it -- its taxpayer
8 identification number. And it seems to me that is not
9 much of a burden on the newspaper if it just has to supply
10 what its taxpayer identification number is.

11 But I am sure it is more burden than not doing anything
12 certainly.

13 It seems to me that the newspaper could just put its
14 taxpayer identification number on its statement -- if it
15 sends a statement. That would be its compliance. Then the
16 payor would have to comply also.

17 Senator Boren. The advertiser would have to file anyway.

18 Mr. Chapoton. If it is over \$600.00 a year. That is
19 correct.

20 Mr. Chapoton. It sounds crazy to me but --

21 The Chairman. The newspapers ought to have withholding,
22 I suppose on the independent contractor.

23 Let's look at it. If not, we just have to decide
24 whether we want to vote on it.

25 Section 355 modification. As I understand, there is

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1 not any revenue involved in that. That is number nine.

2 Mr. Pearlman. Mr. Chairman, I guess there is no revenue
3 involved if the transaction doesn't go forward. The
4 indication we have is that this transaction involves some
5 very substantial assets although, even though we have asked,
6 we do not have the kind of details on the transaction that
7 have permitted us to do a revenue estimate. We don't have
8 that much detail.

9 Mr. Brockway. That is correct, Mr. Chairman. We have
10 been unable to obtain the information to indicate what
11 would be the revenue impact of this transaction if it were
12 to go forward and the law weren't changed.

13 So, we are not really in a position to --

14 The Chairman. When it was discussed with me, I was
15 advised that there would be no revenue impact, so maybe we
16 need to --

17 Senator Bentsen. I was advised that there would be
18 no transaction.

19 Mr. Brockway. It may be that if the taxpayer was
20 taking the position that they wouldn't go through with the
21 transaction or they would restructure it in a different
22 way, then that might be grounds for saying that there
23 wasn't a revenue impact.

24 Senator Heinz. Mr. Chairman, on that one, I have no
25 objection to the principle, but first I want to get something

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1 clear. If we were to apply this principle more broadly,
2 would it be decent acceptable tax policy?

3 Mr. Pearlman. I think we are of the view at this
4 point, Senator, that the way Section 355 is now structured
5 that it would not be acceptable from a tax policy standpoint.

6 Senator Heinz. Why is that?

7 Mr. Pearlman. This provision creates an exception to
8 the present active trader business rules that are contained
9 in Section 355. That requirement was put in the statute for
10 the purpose of limiting narrowly transactions in which
11 business could be split up. This transaction effectively
12 overrides that requirement.

13 I think if the committee were to decide to revisit
14 Section 355 and to determine that the active trader business
15 requirement is no longer appropriate, then I think that
16 certainly is a possibility of making that kind of judgment.
17 That is a different story, but with 355 in its present form,
18 we would say that this exception is not consistent with
19 the Congress' objectives when it designed 355, and it does
20 not represent good tax policy.

21 Senator Heinz. But why?

22 Mr. Pearlman. Because 355 is a safeguard against
23 transactions which permit shareholders to put corporate
24 assets in a form by breaking corporations up into multiple
25 corporations in a form that may permit a bail-out, an ability

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1 to withdraw earnings from a corporation without having
2 dividend consequences.

3 And that bail-out can occur in a variety of ways,
4 including the sale of stock, subsequent redemptions,
5 recapitalizations and the like.

6 I think Senator Bentsen's staff has made a really good
7 faith effort to try to put as many restrictions on this
8 proposal as they could to try to preclude that.

9 Senator Heinz. Are we safeguarded, do you believe,
10 from those kinds of problems?

11 Mr. Pearlman. I think that the provision in the form
12 we most recently saw it certainly made efforts to put
13 safeguards on it. When we raised concerns to Senator
14 Bentsen, they were responded to, but I think there is a
15 broader issue here, and that is are we going to have an
16 active trader business requirement in the statute?

17 And then we are going to say to a taxpayer: If you
18 meet these requirements -- which are going to be very
19 difficult for many taxpayers to meet -- then it is okay
20 for you to disregard that active trader business requirement
21 without revisiting the issue of whether the trader business
22 requirement is appropriate or not.

23 Senator Heinz. Getting back to the safeguards, you
24 used a word that I am always uncomfortable with when I hear
25 it, which is made wonderful efforts. I am more interested

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1 in the results. Are the results of the safeguards
2 sufficient?

3 Mr. Pearlman. I am not sure I can fully answer your
4 question, Senator. The only thing I can say to you is that
5 the concern that we had specifically expressed -- we looked
6 at the transaction. As I say, we looked at the transaction
7 with minimal information. We did not have as much information
8 as we would like to have had. We encouraged the taxpayer to
9 go to the Revenue Service to seek a ruling so that there
10 could be a full disclosure of information with the
11 confidentiality that is afforded that process.

12 We didn't have that luxury -- of having all that
13 information. But with the information we did have, we
14 asked questions that occurred to us, that is, what if a
15 certain thing happened and what if something else happened,
16 and the version of the amendment that I understand is before
17 you sought to respond to those concerns.

18 But whether we have crossed all the t's and dotted all
19 the i's, I can't answer you. I don't know. I don't know
20 enough about what these particular people have in mind to
21 fully respond to your question.

22 Senator Heinz. What was the reason given for not
23 disclosing more information to you?

24 Mr. Pearlman. I am not sure I ever remember hearing
25 a reason. I presume that the people were concerned about

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1 the confidentiality of data. You know, an appropriate
2 concern. It is not affected in the same way as if they
3 were in a rulings position, but I can't answer your question.
4 I don't know.

5 Senator Bentsen. Senator, I would say that some severe
6 restrictions were put on to avoid any bail-out of earnings
7 and put on a period of ten years which would make it --

8 Senator Heinz. Mr. Chairman, do we have those
9 restrictions? I don't have anything on this.

10 The Chairman. We are going to pass it right now.
11 Then you can take a look at it.

12 Senator Heinz. I am sorry. I didn't hear you, Mr.
13 Chairman.

14 The Chairman. I am going to pass over this matter
15 right now, and it will give you a chance to look at them.

16 Number one -- there was a discussion this morning of
17 Senator Danforth's, Senator Mitchell's, and Senator
18 Moynihan's and others. Is there now some agreement on
19 the first item there that we did not complete this morning?

20 Mr. Chapoton. There was a meeting about the time the
21 committee reconvened this afternoon, Mr. Chairman, but I
22 am advised that we have not yet reached an agreement on
23 that. Senator Boren, of course, was concerned about that.

24 The Chairman. What about number two?

25 Senator Moynihan. Mr. Chairman, I believe that --

1 The Chairman. Excuse me. I had the wrong number.
2 Senator Moynihan had pointed out number two, and it is on
3 this list of 22 items. Wasn't that a matter that you were
4 going to discuss with Senator Boren?

5 Mr. Chapoton. No, there was a meeting. I was told
6 there was to be a meeting. In fact, our people came to it
7 with your people and I did not know that an agreement had
8 been reached. In fact, I was advised that an agreement had
9 not been reached.

10 The Chairman. I think Senator Boren is around, so
11 maybe we can work that out this afternoon.

12 All right. Number two. Who is in charge here? Don
13 or Jim?

14 Mr. Wetzler. This is an item that the committee
15 addressed last fall, but there have been a number of
16 problems brought up with what the committee did last fall.
17 And since then, there have been proposals by the Treasury
18 Department. Senator Moynihan has introduced a bill on the
19 issue. And the Ways and Means Committee has acted.

20 And what we did, I think, just at the staff level, is
21 try to put together a compromise proposal, which is
22 described on page 2. It tries to combine the various
23 features of the Treasury's ideas, the committee bill from
24 last fall, and Senator Moynihan's bill, and the Ways and
25 Means bill.

1 I think it starts with the proposal out of Senator
2 Moynihan's bill, which is trying to figure out where to
3 draw the line between options that are going to be taxed
4 under the mark-to-market system such as the futures
5 contracts and other options which are going to be taxed
6 under the ordinary rules, not mark-to-market, and what
7 Senator Moynihan's bill does -- which is the first item on
8 the compromise proposal on page 2 -- is follow his bill and
9 say that equity-based options where the underlying product
10 is a stock are going to be taxed under the ordinary rules
11 and nonequity-based options are going to be taxed under
12 the mark-to-market rules.

13 These rules will apply to investors. Now, for people
14 who are market-makers in options or dealers, there I think
15 it is generally agreed that the mark-to-market system is
16 a much better system for them. And so, under Senator
17 Moynihan's bill and under the House bill as well, all
18 market-makers and options will be taxed under the
19 mark-to-market rules at a maximum tax rate of 32 percent.

20 Now, the second item here is something I think you ought
21 to look at because I think there will be some controversy
22 here. There the Treasury was concerned about the extension
23 of the 32 percent rate to people like market-makers or
24 futures traders whose ordinary business is dealing in these
25 things, and so what this suggests is that you might want to

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1 put a cap of \$150,000 annually on the amount of income that
2 would be eligible for the 60-40 treatment.

3 And the cap in this proposal would be indexed for
4 inflation. That was an attempt to compromise. Treasury
5 had proposed taxing market-makers at a 50 percent rate.
6 Senator Moynihan had proposed 32 percent. And this is
7 an attempt to come somewhere in between.

8 The next item is an item applying the wash sale rules
9 to short sales. There is a little gap in the wash sale
10 rules under present law which enables people to do a
11 transaction called a short sale against the box to create
12 a potential tax deferral for themselves, and this is dealt
13 with in Item 3 of the handout.

14 Item 3 also picks up a provision in the House bill
15 relating to treating market-makers and options as capital
16 gain/capital loss assets, which is the way futures traders
17 are treated under present law.

18 Item No. 4 on the compromise is another new starter.
19 There has been some criticism of the present rules that
20 require taxpayers to identify their transactions. If they
21 are broker-dealers, they are able to identify transactions
22 as investments where the investments are treated as capital
23 gain/capital loss, and there has been some concern that
24 people can sort of make a transaction, wait until the end of
25 the day and if the thing has gone up they identify it as an

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1 investment, and they get a potential capital gain. If the
2 thing has gone down, they identify it as part of their
3 ordinary business where they will get an ordinary loss.

4 The same issue arises in hedging exception, and there
5 has been a report by the New York State Bar, I believe,
6 which urged that the rules be tightened in this area, and
7 the proposal here is to give the Treasury the authority to
8 tighten up the rules by regulation.

9 Senator Moynihan. Mr. Chairman, could we have a little
10 more quiet?

11 Mr. Wetzler. The other item on No. 4 here would be
12 to pick up a provision in the House bill which would broaden
13 the Treasury's authority to deal with so-called mixed
14 straddles. In 1981, you gave Treasury the authority to
15 deal with mixed straddles, but the authority appears not
16 to be broad enough to really come up with a decent solution
17 to the problem.

18 So, this is also a pick-up provision in the House bill
19 that broadens their authority.

20 Now, we would try to work out a statutory solution
21 to the straddle problem if we have time. And if we do,
22 we will try to present it to you later on in the process
23 either for a floor amendment or in conference. So far, we
24 have been unable to come up with a solution ourselves that
25 we think we could recommend to you.

1 And then there is the fifth item here. It would pick
2 up a provision in the House bill that limits the hedging
3 exception to the existing straddle rules. The effective
4 dates are essentially the same type of effective dates that
5 were agreed to back in 1981 for the anti-straddle provisions
6 there, and also are similar to the effective dates in the
7 House bill -- in the Ways and Means Committee bill.

8 The Chairman. Could we hear from Treasury?

9 Mr. Chapoton. Mr. Chairman, I think Jim has outlined
10 our concerns. The mark-to-market is a better system,
11 generally, and certainly in the case of market-makers who
12 engage in numerous transactions.

13 We had a great deal of difficulty supporting a maximum
14 32 percent rate for a particular class of taxpayers for
15 their business activities.

16 The proposed compromise would diminish our concern
17 because, above a certain level, they would be subject to
18 ordinary rates of tax. So, that would certainly be an
19 improvement with us over a straight 32 percent rate.

20 Senator Bentsen. Mr. Chairman, I would like a little
21 more education on this one. When we were trying to work
22 this problem out before in supporting Senator Moynihan,
23 we arrived at a compromise, as I recall, because we had
24 a situation here where we were valuing property at year end
25 and incurring the tax when it wasn't being incurred before,

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1 even though a sale had not been made. Was that not correct
2 and we arrived at a split of 60-40? And that is how you
3 came up with your 32 percent?

4 Mr. Chapoton. The 60-40 is correct. I think the logic
5 of the 60-40 --

6 Senator Bentsen. I am trying to remember how we arrived
7 at that compromise. We were doing something to them that
8 had never been done before --

9 Mr. Chapoton. Absolutely. The something is mark-to-
10 market.

11 Senator Bentsen. That is right.

12 Mr. Chapoton. That they must treat as income or --

13 Senator Bentsen. And we were going to incur it at
14 that point even though it traditionally had not been. Right?

15 Mr. Chapoton. Yes, but in the commodities futures
16 transactions, they actually have the cash in hand, so it
17 is a little different. Now, that is not true in the case
18 of the stocks. The mark-to-market is putting it more on
19 a current basis -- that their losses and gains will be
20 recognized at year end.

21 If I might continue this, Senator, the basic logic of
22 the 60-40, in addition to that point, was that someone
23 estimated -- and I am not sure how valid it was -- but the
24 estimate was made that approximately 60 percent of the
25 commodities traders transactions then were entitled to

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1 long-term capital gains treatment, and 40 percent were
2 short terms.

3 And that rationale does not apply in the options
4 category. There they are all short-term capital gains.

5 Senator Bentsen. Let me ask you this then. This
6 compromise that you are talking about, does that put the
7 options traders in a different position from the commodities
8 traders?

9 Mr. Chapoton. One very attractive feature of this is
10 that it would bring everyone on the level playing field.
11 I think it would -- I want to hasten to add -- cause some
12 concern about it among the commodities traders because they
13 would then have the 32 percent rate up to a maximum where
14 now they have an unlimited 32 percent rate.

15 The Chairman. Is it necessary to have them on the same
16 rate?

17 Mr. Chapoton. The complaint in some of the other
18 categories of options are that they are competing with
19 the commodities people.

20 Senator Heinz. Mr. Chairman, may I make an inquiry?
21 As I understand it, one of the differences between the
22 commodities traders and the other traders is that the
23 commodities have their money.

24 Mr. Chapoton. That is true.

25 Senator Heinz. And the other people are really being

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1 taxed on an inventory value which they may or may not
2 realize. So, if you wanted to take that to a logical
3 conclusion, you could argue -- I think quite credibly --
4 that the noncommodity traders shouldn't be treated as
5 harshly as the commodity traders because they don't actually
6 have the cash, and we are forcing them to pay taxes when
7 they have actually received no cash. That is not the
8 situation with the commodity people. Isn't that right?

9 Mr. Chapoton. You are basically correct. The
10 commodities traders made the same argument.

11 Senator Heinz. The compromise that is being proposed
12 here is to treat them notwithstanding that difference --
13 alike.

14 Mr. Chapoton. That is correct.

15 Senator Heinz. Now, what is our logic for adopting
16 the \$150,000 cap below which income will be taxed under
17 the commodity rules?

18 Mr. Chapoton. I think the logic if I may say -- it is
19 not our proposal -- but what we were saying, Senator, is
20 that --

21 Senator Heinz. I was referring to the amount, i.e.
22 \$150,000. Why shouldn't it be \$250,000? Why shouldn't
23 it be \$50,000. What is the thinking on that particular
24 number?

25 Mr. Wetzler. It is a purely political question. It is

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1 not a technical question. At what rate do you want to limit
2 the ability of people to use the 32 percent.

3 Senator Heinz. What is the revenue effect of raising
4 it from \$150,000 to \$250,000?

5 Mr. Wetzler. We have not been able to do revenue
6 estimates on this, Senator Heinz. There would be some
7 revenue impact.

8 Mr. Susswein. Senator Heinz, part of the impact is
9 contained in the rate tables themselves for run-of-the-mill
10 taxpayers who are generally subject to tax in the regular
11 tax tables. And the regular tax tables don't have a special
12 tax rate. The 50 percent tax rate per married couples
13 begins at approximately \$162,000, so it is essentially based
14 on what all other taxpayers incur.

15 Senator Heinz. I had better state my question with
16 precision. Presumably, there is some revenue gain from
17 the original Treasury proposal. We don't know what it is,
18 maybe we do know what it is.

19 I guess my question is as you place a floor, which
20 you raise up to \$150,000 or \$250,000 or some number like
21 that, and what you are also doing is bringing a ceiling
22 down on the commodity people, in effect, because you are
23 opening their income up above what to the noncommodity
24 traders is a ceiling -- for other people it is now a floor
25 -- and they are being taxed at higher rates.

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1 At what point do you get revenue neutrality?

2 Mr. Wetzler. Senator Heinz, the options market is
3 what they call a zero sum market. For anybody who wins at
4 options, there is somebody else who loses. So, if you
5 look at the aggregate rate, which under Treasury's proposal
6 would be 50 percent, and under the House bill it would be
7 32 percent, there is really probably not a very significant
8 revenue difference between these two because the winners
9 -- when you go down to 32, that helps the people who win,
10 but it hurts the people who lose. And since for every
11 winner, there is an equal loser, roughly speaking it is
12 probably different now.

13 This proposal would raise more money probably than the
14 House proposal or the Treasury proposal because here what
15 we are saying is that losers will still only get their
16 losses deducted on a 60-40 basis, but if you win more than
17 a certain amount, you would eventually have your gains taxed
18 at a --

19 Senator Heinz. But on the compromise --

20 Mr. Wetzler. But we don't know the amount of money
21 involved, but it will involve somewhat more, but it is
22 clearly the committee's decision, if they want to do this
23 at all, where to set that figure. It was not a scientifically
24 derived number.

25 Senator Heinz. I have some problems with the basic

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1 notion of taxing people who have not realized a gain.

2 There are commodities dealers at the Philadelphia Stock
3 Exchange, for example, who will simply not have any money
4 and will be taxed on the money that they have not realized.
5 And therefore, I would be inclined to seek a higher ceiling.
6 \$750,000, \$250,000, or something higher than that.

7 Mr. Wetzler. The options market-makers want a mark-to-
8 market system. They would like a 32 percent rate. Treasury
9 wants a mark-to-market system, but it would like a 50
10 percent rate.

11 Senator Heinz. Yes, I understand.

12 Mr. Wetzler. So, that is what --

13 Senator Heinz. And the compromise that I would like to
14 see is some kind of compromise with a higher ceiling.

15 Senator Moynihan. Would you want to say \$200,000?

16 Senator Heinz. \$250,000.

17 The Chairman. What does Treasury say about this?

18 You get back to Mr. Susswein's point about the average
19 taxpayer -- we are not going to fix his tax rate, are we?
20 Or her rate?

21 Mr. Chapoton. No, that is our point. We think the
22 mark-to-market system makes sense in this area because,
23 without it, they simply can straddle and reduce their tax
24 very significantly. It is almost an impossible task to match
25 their offsetting positions. So mark-to-market is virtually

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1 the only way to tax the market-makers.

2 Then, once you arrive at that conclusion, you start
3 thinking about the rate. It is very hard to say that you
4 are going to single out a certain class of taxpayers and
5 tax their business income at a lower rate than you tax
6 all other people's income.

7 And that is why we simply could not -- even though the
8 argument, I have to say, was made to me, Senator, quite often
9 that at the 32 percent rate they will pay more tax than they
10 do now because they zero out now.

11 That did not endear me to the argument that we should
12 give them a lower rate. I think other taxpayers pay a 50
13 percent rate, and it was just difficult for us to justify
14 a lower rate for anyone.

15 The Chairman. Except I think we have one. We did make
16 a judgment in this committee in 1981.

17 Mr. Chapoton. That is correct.

18 The Chairman. With reference to commodities. Now,
19 after we did change the rules, now we are going back and
20 say we trapped you in 1981, and now we are going to raise
21 your rates again. I mean, there is some question of our
22 credibility involved.

23 Is there any other way to do it?

24 Mr. Chapoton. As to commodities traders.

25 The Chairman. Right.

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1 Mr. Chapoton. Among others, the market-makers in the
2 option field are being put in this for the first time.

3 The Chairman. Right. Is there any other way to do
4 it without the same rate structure?

5 Senator Moynihan. We are leaving the same rate
6 structure. We are putting a limit on how much you can
7 earn under it. I would be willing to see it go to \$200,000,
8 and I don't see how anybody can complain about that.

9 Mr. Chapoton. I think we could get it settled if we
10 went to that -- we would not object to that level.

11 Senator Symms. Mr. Chairman, what is the difference if
12 a guy buys 100 shares of the stock or he buys an option?
13 If he holds the stock for a year, he has got a 20 percent
14 rate, and you are saying that he ought to have a 50 percent
15 rate on an option.

16 Mr. Chapoton. No, options now are taxed on the short
17 term gain, so it is a 50 percent rate on options now.

18 Senator Symms. Are you going to go in next year and
19 say that if a guy buys a piece of real estate property and
20 it goes up, that we should tax him more on his unrealized
21 gain?

22 Mr. Chapoton. No. Senator, we did not propose this.
23 The investor is not going to be affected by this. They
24 have matching rules that were adopted in 1981 -- offsetting
25 positions -- so that they will be affected, but not in the

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1 mark-to-market system. It will prevent recognition of losses
2 when no losses occur. Those rules will be applied to
3 options -- anti-straddle rules.

4 When you get to the market-makers, they came in and
5 they wanted a mark-to-market system, and they wanted a 32
6 percent rate, and I told them -- as I am saying now -- that
7 we think the mark-to-market system is the only one that
8 makes sense, but it is difficult for us to say that we
9 should have a different rate of tax on that class of
10 taxpayers.

11 The Chairman. What is the will of the committee on
12 this?

13 Senator Moynihan. Mr. Chairman, why don't I just take
14 the initiative and say that the Joint Tax Committee has done
15 a good job. I think it solves a real problem, which is
16 that there are two rates of taxation on a similar product
17 at different stages.

18 There would be a question among the commodity traders
19 -- hey, we made an agreement with you and now you are putting
20 a ceiling on us -- but a ceiling of \$200,000 isn't
21 unbearable.

22 And I thought I saw Secretary Chapoton say oh, well.

23 Mr. Chapoton. As Jim said, it is an arbitrary amount
24 and I think you can make the judgment. I have to just take
25 the position that we don't suddenly agree to a lower rate for

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1 another taxpayer.-- for a particular class of taxpayer, but
2 it certainly is better than not having a ceiling on it.

3 I certainly agree.

4 The Chairman. Is there any objection to that
5 compromise? Does anybody want to vote on it?

6 Senator Symms. Mr. Chairman, I would like to set this
7 aside and maybe we could study it a little bit more. Do
8 I understand you correctly that you are talking only about
9 stock and option traders?

10 Mr. Chapoton. Sir, this is not a Treasury proposal.
11 This is a staff proposal. As I understand it, no, the
12 rate would apply to commodity traders as well as --

13 Senator Symms. Does that change what the agreement
14 was in 1981?

15 Mr. Chapoton. No. No.

16 Senator Moynihan. May I say something? We are
17 extending that to people who now feel that they are not
18 on a level playing field because in the commodity exchanges
19 you have the 32 percent rate, and in these other exchanges,
20 you don't.

21 Mr. Wetzler. The way this is written it would apply
22 the cap -- whatever the committee decides the cap to be --
23 to all people who are on a mark-to-market system, including
24 the futures traders.

25 I think the options market-makers may be concerned

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1 about any system in which they are taxed under one regime
2 and futures traders are taxed in a different --

3 Senator Symms. So, you are going to put a cap on
4 the futures traders then?

5 Mr. Wetzler. But it is a decision of the committee to
6 decide whether to have a cap and where to set it. It is
7 not really a technical decision that the staff can give
8 you all that much help with.

9 Senator Symms. But is the cap going to be applied
10 to futures traders, too?

11 Mr. Wetzler. The way this is written, it would.

12 Senator Symms. So, you are changing the 1981 law then?
13 That is what my question was. Isn't that correct?

14 Senator Moynihan. With respect to the amount of
15 income, an individual can acquire at the 32 percent rate,
16 yes, we are. We are making it \$200,000, and after that,
17 you pay 50 percent.

18 The Chairman. If you want to hold it over, Senator
19 Symms, we can bring it up again tomorrow.

20 Senator Symms. Okay. Let's do that then. Let me
21 study that.

22 The Chairman. Let's go to number 12.

23 (Continued on next page.)

24

25

1 The Chairman. Bring it up again tomorrow.

2 Senator Symms. All right, let's do that. Then let
3 me study it.

4 The Chairman. Let's go to Number 12, tax treatment on
5 boundary water canoe payments. That can't be too
6 complicated.

7 Senator Durenberger. Mr. Chairman, this is an effort by
8 my colleague and myself to right a grievous wrong, which
9 you have heard before.

10 When you all got us elected by passing the Boundary
11 Waters Canoe Act, you changed not only the surface but the
12 water use of about a million acres in Northern Minnesota,
13 and there were two forms of compensation, I suppose, for the
14 change in use: One was the usual condemnation or
15 acquisition of resorts or other land, and I am not arguing
16 that one. The other was the fact that over a million
17 acres of land and water area were being serviced by a wide
18 variety of small businesses that were sports recreation
19 related. They were outfitters; they were sports stores,
20 and so forth.

21 Recognizing that there would be an impact when you take
22 all the motors off the lake and everybody is going into the
23 canoe business rather than the motor business, and were
24 going to stay there, you all very wisely provided for a
25 financial assistance program for these kinds of businesses.

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1 So in 1980 or '81 we put the program together. Most of
2 the grants of the program are in the \$2500 category, to about
3 36 or 38 people. Twelve or 14 of them are up in the \$25,000
4 to \$50,000 category.

5 Mainly what these people did was this: If they
6 converted from power boats to canoes, they used \$2500 to
7 help in that conversion. Obviously they could have gotten
8 along just fine with that equipment, but they had to sell it
9 and go to canoes. It was the same thing trading down from
10 a larger boat to a smaller boat.

11 In addition, there was a provision in each contract
12 that says two things: First, no more than 25 percent of the
13 cost of acquisition or improvement of the property could
14 come from this grant program. So people had to dig up at
15 least 75 percent of their own money in order to make this
16 acquisition. And secondly, a provision in each grant
17 required repayment of a prorated portion of the grant if
18 the business were sold. That, to me, is the key
19 distinction between this kind of a transaction and anything
20 else. If those people, in accepting that payment, if I
21 can't sell you on the notion that they were being
22 compensated for a forced sale, in effect, which I am beyond
23 trying to make, there was a clause in every grant that
24 required repayment of a prorated portion of the grant in
25 case the business were sold. In fact, two repayments have

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1 already been made, and a third is in process.

2 So we are talking about a total of about a million
3 dollars, according to the Forest Service, or about 50 to
4 100 people.

5 The Chairman. Does the Treasury have a position on
6 this?

7 Mr. Chapoton. Well, our position has been the same,
8 I believe, as it was before. It seems to me it ought to be
9 something that could be resolved, provided we put it in the
10 category of the involuntary conversion. I think,
11 unquestionably, it is related. If not exactly an involuntary
12 conversion, certainly it is close to that. So that the
13 amounts received can reduce the basis of other business
14 assets or roll over and be tax free; as long as they are
15 traced or like amounts are put in other business assets, we
16 would certainly have no problem with that. But if it is not
17 some adjustment, just granting the tax-free payment when there
18 is no basis reduction elsewhere, then we do have difficulty
19 with that.

20 Senator Durenberger. Well, maybe that is part of the
21 solution.

22 Mr. DeArment. Then, if you followed the involuntary
23 conversion to the extent that there are these repayments
24 made, then there would be a restoration of basis to the
25 extent of the repayment.

1 Mr. Chapoton. That is correct, it would work fine.

2 The Chairman. Is that all right, Dave?

3 Senator Durenberger. Well, I'll try to work something
4 out on that.

5 The Chairman. All right. Let's go ahead, and if you
6 can, work it out, then Treasury will notify us. We will
7 leave it on the list.

8 What about Number 13, the church audits?

9 Senator Matsunaga. Mr. Chairman, I think we are ready
10 for Number 15.

11 The Chairman. Are you ready for Number 15 while you
12 are looking at 13?

13 Is that yours, Sparky?

14 Senator Matsunaga. Fifteen is mine.

15 Mr. Chapoton. I need to have a discussion with you,
16 though, Senator.

17 Senator Matsunaga. The staff agreed, I think.

18 Senator Grassley. Mr. Chairman, on Number 13 we still
19 have one difference between the IRS and those of us who are
20 sponsoring that bill that have to be worked out.

21 In fact, I haven't even had a chance to consider their
22 point yet. That is on the church audit.

23 The Chairman. All right. I guess my question is,
24 will you have it worked out by tomorrow morning?

25 Mr. Pearlman. We are very close, Mr. Chairman.

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1 The Chairman. We can't keep going over the things.
2 I don't fault anybody, but there are 22 items here, and we
3 may end up with 15 when we leave here, the way we are going.
4 We disposed of about a dozen this morning.

5 So, do you have a subcommittee in Treasury that could
6 be working on that?

7 Mr. Pearlman. They have been. I think the staffs have
8 been working. They met over lunch, and there is one open
9 item. We have made a suggestion to Senator Grassley on
10 how to resolve it, and we are simply awaiting a response
11 now.

12 The Chairman. All right.

13 Is yours 15, Sparky?

14 Mr. Chapoton. Yes. Mr. Chairman, if I could, on
15 15, I would like time to discuss that with Senator
16 Matsunaga privately.

17 The Chairman. Are you getting close?

18 Mr. Chapoton. Well, I want him to understand a couple
19 of features of our point.

20 The Chairman. Well, why don't you step in the back
21 room and do that while we are doing something else.

22 Is that all right, Buck?

23 Mr. Chapoton. Yes, sir.

24 The Chairman. Let's go to 14, then.

25 Senator Boren. Mr. Chairman, could I go back to 8 for

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1 one second? I think it will take 30 seconds.

2 The Chairman. Sure.

3 Senator Boren. I don't think that Mr. Chapoton and I
4 were in full communication with each other a while ago, and
5 I now understand. We are on the same track.

6 I would like to just have a technical amendment to take
7 care of that in the way that was suggested, in terms of
8 taking the perjury requirement out, so that they could print
9 it on the top of their statement or use some other method of
10 making that kind of notification, if we could.

11 Mr. Chapoton. That's fine.

12 Senator Boren. We could handle that as a technical
13 amendment.

14 Mr. Chapoton. All right. Or, if it would be
15 satisfactory to you, we could handle it in the committee
16 report, because we think if it were clear -- maybe we ought
17 to do it as a technical amendment just to make sure that we
18 have it down the right way.

19 Senator Boren. Would that be all right?

20 Mr. Chapoton. Yes, sir. That's fine.

21 Senator Boren. And Mr. Chairman, with that, I think
22 we could handle it as a technical amendment, and there would
23 not be any problem, that we are in full understanding on how
24 we would do that.

25 The Chairman. All right. So Number 8 has been agreed

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1 to?

2 Mr. Pearlman. Yes.

3 The Chairman. All right.

4 Let's go on to 14. You are going to work out 15 right
5 now in the back room, Buck, with Sparky.

6 Mr. Brockway. Mr. Chairman, 14 is a transitional rule
7 to the safe harbor leasing proposals, dealing with coal
8 gasification, where taxpayers would be limited to one-half
9 of a basis of no more than \$135 million. It would be a
10 revenue loss of \$16 million.

11 The Chairman. All right, without objection.

12 What about 16?

13 Mr. Brockway. Senator Wallop's proposal.

14 Mr. Pearlman. Mr. Chairman, I think we have reached
15 agreement with Senator Wallop.

16 The Chairman. So I understand. Could you describe
17 the amendment for us briefly, Ron, or Dave?

18 Mr. Pearlman. This is an amendment that will simply
19 make it clear that, in the event of a person who owns the
20 surface rights to mineral property but does not own the
21 underlying mineral rights, and did not own those mineral
22 rights at the time of the enactment of the deduction for
23 a conservation easement, that provided that there is no
24 relationship between the owner of the mineral rights and
25 the surface rights, that a conservation easement on the

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1 surface rights could be contributed without adversely
2 affecting the charitable deduction. And Senator Wallop
3 has developed a proposal to achieve that objective that
4 we are comfortable with.

5 The Chairman. This is a situation where the likelihood
6 of surface mining would be remote, as I understand it.

7 Mr. Pearlman. That is correct. Right.

8 Mr. Brockway. And I gather it is generally in the
9 direction where you would have gone?

10 The Chairman. Is it safe to say that there is no
11 objection by the Treasury, the Joint Committee, or the
12 Finance Committee staff?

13 Mr. Brockway. That is correct.

14 Mr. Pearlman. Yes.

15 The Chairman. All right. Without objection, we will
16 agree to that amendment.

17 Senator Moynihan. Mr. Chairman, could I say for the
18 record that Senator Wallop is holding a hearing in the
19 Intelligence Committee. That's why he is not here.

20 The Chairman. Right. He indicated if we could take it
21 up without objection, it would be fine, and if there was
22 he would want to be called.

23 What about Social Security coverage for church
24 employees? Caroline?

25 Senator Moynihan. I believe we have worked out a very

1 attractive agreement on that.

2 Mr. Pearlman. Mr. Chairman, let me just mention that
3 Treasury had indicated its concurrence in that in your
4 proposal, and indeed I think today we delivered a letter to
5 you to that effect on the Social Security coverage. But I
6 need to advise you that OMB has not yet given us clearance.
7 There was some question at the Social Security Administration.
8 We are trying to obtain a clearance by telephone now, and
9 we would like to be able to communicate that to you.

10 The Chairman. Fine.

11 All right, Caroline, would you explain sort of the
12 genesis of all of this? We have had a number of discussions,
13 going back to what? Last November?

14 Ms. Weaver. Yes, back to November.

15 The Chairman. So will you just sort of walk through
16 it quickly for some who weren't apprised of it earlier?

17 Ms. Weaver. Yes.

18 The 1983 Social Security Amendments mandate Social
19 Security coverage for all employees of all nonprofit
20 organizations. That includes employees of all churches and
21 religious organizations.

22 It was brought to the committee's attention late last
23 year --

24 Senator Moynihan. Mr. Chairman, may we have order?

25 Ms. Weaver. It was brought to the committee's

1 attention late last year that there were a number of
2 concerns about the mandatory tax on churches, and in
3 particular that churches would be required to withhold the
4 employee tax on behalf of all church employees, and in
5 addition would have the liability for the employer's share
6 of the tax.

7 We have been working for the last couple of months to
8 try to work out a way to maintain mandatory coverage for
9 employees and yet redistribute that tax burden in such a
10 way that it in effect got it off the church in cases where
11 the church had a religious opposition to the payment of
12 that tax.

13 To this point, the option we have been discussing would
14 basically allow churches and other religious organizations
15 that are religiously opposed to the payment of the Social
16 Security tax to elect on a one-time irrevocable basis to
17 treat all of their employees in a different way. In
18 particular, they would be able to withhold from their
19 employees at the higher self-employment tax rate. That
20 would therefore relieve the church of the liability for the
21 employers share of the tax, but they would still be
22 required to withhold on behalf of employees at the higher
23 self-employment tax rate.

24 The Chairman. The Treasury may have agreed that they
25 would report rather than withhold. Is that correct?

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1 Ms. Weaver. Now, we have continued to discuss this
2 option, and we believe Treasury would support not requiring
3 the churches to actually withhold at the self-employment
4 rate but to allow each of the employees to simply pay the
5 taxes as self-employed for the purposes of Social Security
6 alone.

7 The Chairman. Is that correct?

8 Mr. Pearlman. That is correct, Mr. Chairman. The only
9 thing, we think the reporting is very important in this
10 proposal, and our only suggestion in that regard is that,
11 if the committee adopts that option, with which Treasury is
12 in agreement -- I have to qualify that, I can't yet tell you
13 the Administration is -- that we think that it is desirable
14 to include in the provision a further qualification: If a
15 church fails to provide the information for two
16 consecutive years, and fails to provide it when requested
17 by the Revenue Service after that two-year period, that it
18 would no longer be entitled to the special exception. That
19 is simply to assure that the information is forthcoming.

20 The Chairman. I would say that I wouldn't have any
21 objection. This was originally raised by Senator Jepsen,
22 and we have met a couple of times. I know you have met
23 I don't know how many times, Caroline, and other staff
24 members, and Treasury, with different groups.

25 Now, some would simply postpone, is that correct?

1 Ms. Weaver. That is correct. Senator Jepsen's bill
2 would be a two-year delay of the present law provision
3 allowing optional participation.

4 The Chairman. And that would reduce the fund by how
5 much? Two billion?

6 Ms. Weaver. That is 1 billion over the two-year
7 period.

8 The Chairman. Oh. One billion.

9 Ms. Weaver. Yes.

10 The Chairman. And this is revenue-neutral?

11 Ms. Weaver. We have a revenue estimate that there
12 would be a revenue loss of \$80 million over the period 1984
13 to 1987. That is coming from the fact that self-employed
14 people get a tax credit that allows them to pay a slightly
15 lower net amount into the trust funds. And, in addition,
16 there will be some reduction in compliance, presumably.

17 Senator Moynihan. But, Mr. Chairman, this does have
18 the virtue of settling the question.

19 The Chairman. But I am not certain what the House will
20 do. I suggest some of those who did not want any
21 compromise, we could bring up the postponement and vote on
22 it. I didn't think it would pass; but it would be my
23 recommendation -- we have spent a lot of time; certainly
24 you have, and other staff members -- to take the compromise
25 if in fact Treasury agrees there will not have to be more.

1 withholding, but reporting, and adopt the Treasury
2 provision on the two-year provision.

3 Mr. Pearlman. Mr. Chairman, let me just mention that
4 if you don't have reporting the revenue loss creeps up to a
5 very substantial amount of money again. And that was the
6 reason for trying to put some encouragement on information
7 reporting.

8 May I mention just one other additional item? A number
9 of churches, as I know you are aware, opted to be in this
10 system, elected to be in this system, because they wanted
11 their employees covered and they had no desire to not to be
12 included.

13 The Chairman. Jerry Fallwell's church, for example.

14 Mr. Pearlman. And when the Social Security Amendments'
15 revenue estimates were done, and when the revenue estimates
16 for the Jepsen Amendment were calculated, we did not assume
17 that all of those people who had specifically elected into
18 the system would be given an opportunity to elect out.

19 So we are suggesting that, in order to protect the
20 revenue estimate, that those churches that chose to
21 participate in the system not be given the opportunity to
22 elect out of the system, since they had made that choice
23 on their own.

24 Ms. Weaver. Under the staff option, we would have
25 allowed all religious organizations to make a fresh

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1 decision. The argument there being that, as long as the
2 tax was voluntary, it is a very different decision for the
3 church than when it becomes mandatory.

4 Senator Moynihan. Mr. Chairman, I would like to suggest
5 that I think Caroline has a point there. We want to let
6 every church start out and make this election. It is an
7 irrevocable election. And almost all of those who have done
8 will do.

9 The Chairman. I don't think that is a major matter,
10 is it?

11 Mr. Pearlman. Well, it is not as far as we are
12 concerned; but it may be from Social Security's standpoint.
13 As I say, at this point, if you choose not to do that, I
14 have got to report back to you anyway on what the
15 Administration's position is, but this was a major item to
16 the Social Security Administration.

17 Senator Boren. Mr. Chairman, let me ask this question:
18 There is very little revenue impact here, but let's say you
19 are dealing with the individual employee of a church. If
20 they were covered, they would pay what? Seven percent?

21 Ms. Weaver. They would be paying 6.7 percent.

22 Senator Boren. They would be paying 6.7 percent. Now
23 the church that the person works for opts out as an
24 organization. They opt out of the system. Now, the employee
25 then becomes self-employed; is that correct? So the employee

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1 then must start paying 12 percent?

2 Ms. Weaver. Eleven-point-three.

3 Senator Boren. Eleven-point-three. Well, you know,
4 that could be pretty rough on some of these people, because
5 a lot of them are not that highly paid.

6 The Chairman. We are trying to avoid the
7 constitutional question.

8 Ms. Weaver. We also are maintaining present law for
9 any religious organization that does not oppose the payment
10 of taxes. And presumably that would be a large proportion
11 of the churches.

12 Senator Boren. But it has to be a church election as
13 opposed to an individual election?

14 Ms. Weaver. Yes.

15 The Chairman. They could raise their pay. You could
16 put in a little more on Sunday.

17 Senator Boren. But a lot of them don't have the money
18 to raise the pay with; that's what concerns me. You know,
19 a lot of the smaller churches.

20 The Chairman. All right, then. You are recommending
21 that, even though some have opted in, they could also opt
22 out? In other words, changing the rule? Is that it?

23 Ms. Weaver. They would have a new election to treat
24 their employees differently.

25 The Chairman. Like a fresh start?

1 Ms. Weaver. Yes.

2 The Chairman. Like bankruptcy, the same concept; you
3 would have a chance to start over.

4 And Treasury opposes that?

5 Mr. Pearlman. Yes. At this point I think we would have
6 to say we oppose that. The election into the system predates
7 the Social Security Amendments. Many churches made those
8 elections a number of years ago. I don't remember when it
9 started.

10 The Chairman. Maybe that's how you would work it out --
11 if they had made an election prior to 1981, maybe that would
12 be the breaking point.

13 Mr. Pearlman. That is a possibility.

14 The Chairman. Let's do it that way. If they haven't
15 been adversely affected by what we did in the Social Security
16 Act.

17 Mr. Pearlman. Since 1983?

18 The Chairman. Yes.

19 Mr. Pearlman. All right. Let's see if we can do it
20 on that basis.

21 The Chairman. All right. Let's agree to that, and if
22 it doesn't work we will agree to something else, or we won't
23 agree on anything.

24 (Laughter)

25 Senator Bentsen. Mr. Chairman, the Gulf Coast

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1
2 amendment was not put on this particular list, and I would
3 like for staff to look at it overnight and see if we couldn't
4 work it out where the fees that are to be determined are
5 treated as if the financing was taxable. We are talking
6 about a nonprofit organization, in effect.

7 So if they would look at that and see if we couldn't
8 get that on the agenda in the morning.

9 I would like to ask another question of the
10 representative of the Treasury, and that is on the question
11 of the distribution of appreciated property that we discussed
12 previously.

13 Would we have the same kind of proposal on a transition
14 rule that is in the House bill? Do you see any problem with
15 that? It is in the House bill, the transition rule.

16 Mr. Pearlman. Yes.

17 Senator, I would like to be able to take a look at the
18 transition rule, because I don't remember it, but I would
19 presume we would not have a problem with the transition rule.
20 But, if you will permit me, I would like to take a look at
21 it first.

22 The Chairman. All right. Let's take a check so we can
23 do that the first thing tomorrow morning.

24 Senator Bentsen. And let me ask you one more, and that
25 is one of the non-controversial items that was agreed to, the

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1 provision to permit installment treatment of estate taxes in
2 the case of a holding company that owned one first-tier
3 operating company. I would like to suggest that the
4 same treatment be extended to holding companies that own
5 lower-tier operating companies or that own more than one
6 first-tier operating subsidiary. I don't see why there
7 would be a distinction drawn between the two, and I would
8 like the Treasury to look at that.

9 Mr. Pearlman. All right. That issue had been raised to
10 us, and we will be prepared to comment on that tomorrow,
11 Senator.

12 I think we need to do some more work on it.

13 Senator Bentsen. I just don't see a difference in
14 treatment there, and I would like the Treasury to take a
15 look at it.

16 Mr. Pearlman. All right.

17 The first one you mentioned, Senator, I just want to
18 make sure because that is not one I am familiar with, could
19 you describe that? You mentioned the name.

20 Senator Bentsen. That was the question on the
21 appreciated property distribution.

22 Mr. Pearlman. I thought you had one previous to that,
23 a prior one.

24 Senator Bentsen. Oh. I was speaking to staff on the
25 Gulf Coast Treatment Plant which is a nonprofit system on

1 the Gulf Coast of Texas.

2 Mr. Pearlman. All right.

3 Senator Bentsen. And the question was: In the
4 situation there, where they have sold tax-free bonds --

5 Mr. Pearlman. That is Section 103?

6 Senator Bentsen. That is correct. Then the question is
7 how they charge fees. Do they charge fees based on taxable
8 bonds or nontaxable bonds? And they get into a real problem.
9 Again, it is a nonprofit regional entity.

10 Mr. DeArment. Yes, we are familiar with that, and we
11 will go over it with Treasury and the members of your staff.

12 Senator Bentsen. All right.

13 The Chairman. All right. Then we will be prepared to
14 take those up the first thing tomorrow morning. We will
15 put them at the top of the list.

16 Senator Moynihan?

17 Senator Moynihan. Yes. Mr. Chairman, could I
18 interest you in \$100 million?

19 The Chairman. Do you mean picked up, or lost?

20 Senator Moynihan. A pickup.

21 The Chairman. If it's like the luxury cars, I don't
22 know.

23 (Laughter)

24 Senator Moynihan. It is a very simple proposal. It is
25 to allow the Treasury to exchange tax information with New

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1 York City, and other cities if they so desire.

2 New York City is the fourth largest government in the
3 country, with respect to revenue collection, and they would
4 like to -- at present, the Federal Government exchanges
5 tax information with the States. And it has been a good
6 arrangement in terms of compliance. The City of New York
7 would like now to have permission to exchange information
8 with the Federal Government.

9 They estimate that they would gain some \$25 million in
10 revenues over two years, and the Federal Government would
11 raise \$100 million. So, on our three-year chart it would
12 be 150.

13 We would have to amend Section 6103(d)?

14 Mr. Brockway. That is correct.

15 Senator Moynihan. And I suppose we could do it in any
16 way you like. You might say any city over a population of
17 2 million. This is an optional thing. The Treasury doesn't
18 have to do it if it doesn't want to do it, but I think you
19 found it to be in your interest to do it with States.

20 Mr. Pearlman. That is correct.

21 The Chairman. Do you have any objection to his
22 proposal?

23 Mr. Pearlman. I think, basically we don't. But we
24 just received a copy of the proposal, and we would at least
25 like to let the Revenue Service take a look at it, let us

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1 review it,

2 Senator Moynihan. Oh, sure.

3 Mr. Pearlman. Maybe we could report back tomorrow
4 morning on that, Senator.

5 The Chairman. Are you familiar with it, Dave?

6 Mr. Brockway. Well, I am familiar with it. This would
7 allow the exchange of information with the local income
8 tax. I am not sure that we feel there is \$100 million of
9 revenue in it; but it certainly would improve compliance
10 both at the Federal level and at the city level.

11 The Chairman. Well, we wouldn't lose any, right?

12 Mr. Brockway. Clearly not; it would raise some revenue.
13 I am not sure how much.

14 Senator Symms. Mr. Chairman, let me just throw out one
15 point when you are looking at this, and then we can look at
16 it tomorrow. Let's be sure that if this is going to take
17 place, and I understand from the size and scope of New York
18 City that it is different from some rather small communities
19 around the country; however, let's don't get it so that every
20 mayor in the country can decide he wants to go get the
21 income tax return of the local businessman that he is having
22 a feud with and harass him. I mean, I think there has to be
23 some kind of a cautionary factor here.

24 Mr. Brockway. That is one of the basic concerns, even
25 with the exchange of information with the States. And

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1 certainly we would be looking very closely at that to make
2 sure that it could not be used for anything other than
3 tax collection purposes under an income tax in place in
4 these cities, and that there are full safeguards.

5 Senator Symms. Let me just carry this down the road.
6 If the city of New York can do it, and let's say the city
7 then of Des Moines, Iowa, decided that they are going to have
8 some kind of an income tax, and then they want to look at
9 some of these tax returns, and pretty soon you have got
10 people's privacy being interfered with.

11 Senator Moynihan. Well, Senator, if I could say, we
12 would assume the same confidentiality standards as with the
13 State governments. And if you want to limit it to cities of
14 over 5 million, or something like that --

15 Senator Symms. I think the Senator wants to protect
16 the same thing I am talking about.

17 Senator Moynihan. Yes.

18 Senator Symms. But when you look at this, let's be sure
19 that is taken into account, so in the morning you have got
20 that answered.

21 Mr. Brockway. Certainly.

22 The Chairman. Did we work it out with Senator
23 Matsunaga?

24 Mr. Chapoton. Yes, I believe so, Mr. Chairman.

25 The Chairman. This is Number 15?

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1 Mr. Chapoton. This is Number 15.

2 Senator Matsunaga. Yes, Number 15.

3 Mr. Chapoton. Senator Matsunaga is proposing extending
4 the rule now applicable to pension funds, that debt-financed
5 property does not give rise to unrelated business income.
6 That is now the rule applicable to pension funds. He would
7 suggest extending that to educational organizations.

8 We had wanted last Fall and have renewed now, and I
9 think Senator Matsunaga has agreed, that we would put
10 restrictions on the ability to exclude debt-financed
11 property from tax-exempt income, both with respect to
12 educational institutions and with respect to pension funds,
13 and those restrictions would be three:

14 One is, if it is in a partnership, all of the partners
15 in a partnership would have to be tax exempt.

16 Secondly, that there be no nonrecourse financing.

17 And third, a related item, that there be no seller
18 financing of the real estate.

19 Those restrictions would of course be applicable on
20 a prospective basis to investment by pension funds, if they
21 are to be excluded from the debt-financed rules, and to
22 educational institutions as well.

23 The Chairman. Is that it, Senator Matsunaga?

24 Senator Matsunaga. Yes.

25 Mr. Chairman, this is S. 1183, which was cosponsored

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1 by Senators Long, Bentsen, Durenberger, Grassley, and
2 Moynihan, and we are agreeable to the restrictions
3 suggested by the Treasury.

4 The Chairman. All right, then, if there is no
5 objection; I guess you will draft it and then Senator
6 Matsunaga can take another look at it?

7 Mr. Chapoton. Yes, sir. That will be fine.

8 The Chairman. It will be agreed to.

9 I wonder, Mr. Chapoton, if maybe you and Senator
10 Packwood could visit now. You did pretty well with
11 Matsunaga in the back room.

12 (Laughter)

13 The Chairman. On the VEBAs. And then we will continue
14 to take up some noncontroversial ones while you are gone.

15 Now, where is Senator Grassley?

16 I think we have, on Number 1, the clarification of
17 the prepayment provision. I think we can agree on the
18 livestock provision. I understand Senator Boren and
19 Senator Grassley don't have any problem with that, and that
20 was the only thing I was raising earlier.

21 Is that correct, Senator Boren? Let's see if this
22 has been resolved.

23 Senator Heinz. Mr. Chairman, while they are making up
24 their minds on that, how many more items would you like to
25 do today? It is nearly 4:30, and we have been in session,

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1 counting our caucus, since about 9:15.

2 It is not only inconvenient for all of the lobbyists,
3 but some of us have other things we have to do, too.

4 The Chairman. Right. I don't expect to do the whole
5 list today.

6 Senator Heinz. Well, what are your intentions?

7 The Chairman. I would like to see if we can agree to
8 this one, go back and do VEBAS if Senator Packwood can work
9 that out, and I would hope we might have discussed the
10 copper, zinc, and lead Superfund tax, but both Senators
11 involved are not present.

12 Let's see, church audits? We need a little more work
13 on that. I assume we might get into 19 and 20.

14 Senator Boren. Nineteen and 21. Now, is Senator
15 Moynihan in the area? He just walked out, but Senator
16 Moynihan and Senator Matsunaga have an interest in the
17 fringe benefit thing.

18 The Chairman. I would just say for Senator Heinz's
19 benefit, we may discuss 19, 20, and 21, just three more
20 items.

21 Senator Heinz. Thank you, Mr. Chairman.

22 The Chairman. Then tomorrow morning we will start again
23 at 10:00 and probably work tomorrow night, because we are
24 not going quite as rapidly as we thought.

25 Senator Boren. Did you ask a while ago, was it just the

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1 farm issue on the prepayment? I understand that has been
2 resolved. So we are still working on the other generic part
3 of the provision.

4 The Chairman. I don't have any problem with the other
5 part, do you?

6 Senator Boren. We still have some problems with the
7 other part, but they are trying to get them resolved, as I
8 understand.

9 The Chairman. The problem is, we just don't adopt
10 the other part. Then there is no problem.

11 Senator Symms. Mr. Chairman, could we just go through
12 that one more thing on prepayment? I don't want to delay
13 this, but I guess the part that is still bothering me is,
14 and maybe I should address the question to the Treasury, that
15 if a guy buys the feed for the cattle, whether he lives on
16 the farm or he lives in town, and he has a big income, the
17 cow can only eat so much per day. He may get a better
18 price by buying it all at once. What do you want to do, put
19 him on an accrual basis? Is this what you are trying to do?

20 Mr. Pearlman. No, we don't want to put him on the
21 accrual basis; but in the year-end prepaid feed situations,
22 Senator, the taxpayer is purchasing the feed on December 31,
23 or very late in the year, versus January 1 or very early
24 in the year, solely to move that deduction from one year to
25 the other.

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1 If he wants to wait four days and make his purchase
2 on January 1, recognizing then that the feed will be
3 consumed throughout the year --

4 Senator Symms. Well, what if he bought it in October?
5 And he bought enough to feed these cattle through. And say
6 they are going in the feedlot, and he paid for the feed, and
7 he takes them out February 15th? How does it work? It just
8 seems complicated to me, what you are trying to do.

9 If they are on a cash accounting system, what is the
10 problem?

11 Mr. Pearlman. We are now talking about the non-farmer,
12 all right? The fellow who is not a farmer.

13 Senator Symms. But he is feeding cattle.

14 Mr. Pearlman. But he is feeding cattle, right, or having
15 cattle fed for him -- that may be better.

16 Senator Symms. All right.

17 Senator Grassley. Let us emphasize, he doesn't have
18 dirt under his fingernails.

19 Mr. Pearlman. And he definitely does not have dirt
20 either under his boots or under his fingers. That is right.

21 Senator Symms. But he is taking the risk that as the
22 price of cattle goes down he may lose, and you won't pay him
23 interest back on that.

24 Mr. Pearlman. No, I don't think we pay any taxpayer
25 interest on losses. I mean, they get their deductible loss,

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1 and he will get his deduction for feed.

2 Senator Symms. But you want him to pay you interest on
3 it. That is what you are saying.

4 Mr. Pearlman. No, I don't think that is an accurate
5 statement, Senator. What the entire package of time value
6 of money proposals is trying to do is to recognize the
7 significance of different taxable periods.

8 You gave an example of the taxpayer who buys a year's
9 worth of feed in October, who takes a deduction in October
10 for that feed, even though we recognize that whether he
11 has a loss of the cattle or a profit on the cattle, that it
12 is going to occur in a subsequent period, in the next year,
13 for example, in a typical feed situation.

14 And it seems to us that the better matching of income
15 and expense is to put the deduction for feed in the year
16 when it is consumed, because that is more likely to match
17 with the profit or loss he ultimately has on the sale of
18 the cattle.

19 Senator Symms. Well, I will just make my point one
20 more time. And I am not going to delay this, except to say --
21 and Senator Boren brought this up earlier -- what do we do
22 to this non-farm cattle feeder that does have an impact on
23 agriculture? Because maybe farmers sell their feeder cattle
24 to these non-farmer cattle feeders. And if this person can
25 buy this feed at a better price, he may have to go down to

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1 the bank and sign a note for 12 percent interest or more,
2 and pay, and write the check. And he is paying interest
3 on that on a daily basis. And yet the Treasury is turning
4 around and saying, then, he can't take that deduction. But
5 he actually had to write the check for the feed. That is
6 what you are saying. What if the cattle don't eat it? Maybe
7 they eat all they can eat up to December 31st, and then in
8 January you say -- is that correct?

9 Mr. Pearlman. Well, it is an inventory item. You know,
10 when I go out and buy a building, and I borrow money and
11 pay interest on that building, the Treasury does not permit
12 me to take a deduction for that building in the year of
13 purchase. What we are trying to do is match the expenditure
14 more closely to the economic consumption.

15 Senator Symms. Yes, but we are talking about people
16 who are putting up cash. They are writing a check out to
17 go buy these cattle.

18 Mr. Pearlman. Well, not all of the deals. The Shultz
19 cattle that we described to you, they wrote out a check of
20 a dollar, borrowed --

21 The Chairman. Eight-to-one, wasn't it?

22 Mr. Pearlman. Well, the actually facts are, a cash
23 investment of \$7000, a revolving note of \$49,000, and a
24 deduction for \$56,000.

25 Senator Symms. For ever one of those somebody lost money

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1 trying to do that, though.-- for every one of those that
2 you point out.

3 Mr. Pearlman. Well, we are not taking away the loss
4 deduction, Senator.

5 Senator Symms. No.

6 Mr. Pearlman. You know, the taxpayer who loses money
7 will still get a deduction for the loss.

8 Senator Boren. Mr. Chairman and Senator Symms, I think
9 that during the course of these negotiations on the
10 agricultural part of it, that we now have worked out an
11 agreement with the cattlemen's association and others --
12 Senator Grassley's people I think have all been involved
13 in working this out.

14 I think we have now satisfied it, where we have
15 legitimate investments and actual losses, that this isn't
16 going to be prevented from being deducted. So I would
17 suggest -- we have not worked out the generic part of it,
18 but I would suggest we could go in and adopt the agricultural
19 section.

20 The Chairman. I assume there are some savings in this
21 piece. Is that correct?

22 Mr. Pearlman. There will be some revenue pick-up, I
23 would expect, from current law in this piece. But one of
24 the things I guess we need to make sure of is, I guess we
25 are leaving Senator Boren's broader proposal that was

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1 adopted last week.

2 The Chairman. Well, we are just trying to agree on this
3 one minor provision.

4 Mr. Pearlman. So this is a modification to that.

5 The Chairman. Right.

6 Senator Grassley. This is just the agricultural part,
7 not the generic part on the other section.

8 Mr. Pearlman. Right.

9 The Chairman. Let's agree to that, if it is all right
10 with you Senator Grassley. Senator Symms, are you fairly
11 well satisfied?

12 Senator Symms. I have said my piece, Mr. Chairman.

13 The only thing I feel bad about is, I wish some of the
14 people who write these things would take some of these risks
15 sometimes so that they know what these people do when they
16 worry at night about what is going to happen to the price
17 of cattle while they are doing this, because whether they
18 spend cash or borrow the money is really irrelevant. If they
19 sign their name on the dotted line, they are obligated for it
20 and they are liable for it. That is the point we were
21 missing here. That is my whole point.

22 Now, there may be some bad things that have happened,
23 but I think it all comes out in the wash if you are on a cash
24 basis; sooner or later you have to pay the tax on it, if you
25 make a profit. If you don't, you are going to be paying

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1 Treasury time cost of the money. That is my whole point.
2 I think it is a bad principle. But I drop the subject at
3 this point.

4 The Chairman. All right. Let's move, then, to
5 generation skipping, Number 19.

6 That has been agreed to, the Grassley-Boren
7 modification.

8 I wonder if maybe we could get into the Superfund,
9 since we have both principals here.

10 Senator Matsunaga. Does that mean Number 1 is adopted?

11 The Chairman. Number 1 is partially adopted --
12 partially.

13 Unless we can agree on generation-skipping -- Steve?

14 Senator Symms. I am ready.

15 The Chairman. Is the Treasury ready on generation-
16 skipping?

17 Mr. Pearlman. Well, I am not ready, Senator.

18 Senator Symms. We don't agree.

19 Mr. Pearlman. Yes. We don't agree; that much I know.
20 But that's about where it stops.

21 Senator Symms. Mr. Chairman, I would just say we have
22 talked about this for three years now, and I would just like
23 to say that the Bar Association from several States --
24 California, New York, and many others -- the American Bar
25 Association from the whole country, the CPAs, the bankers,

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1 the College of Probate Counsel, many of the State
2 Bar Associations -- have all looked at this, testified on
3 it, and said what we should do is to repeal the law. They
4 have never raised any money from it. Treasury hasn't been
5 able to apply the present law to the situation, and I would
6 just like to move that we repeal the generation-skipping
7 tax.

8 What Treasury is proposing here, as I understand it, is
9 a new concept to the law, which we have never had hearings
10 on. And I would pledge, as Chairman of that subcommittee,
11 we will have a hearing on it and start over, if they have
12 a proposition they want to bring.

13 But, for right now, Treasury doesn't know how to operate
14 this thing. All the experts in the country have looked at
15 it. There hasn't been any revenue to the Treasury from it,
16 and this direct skip that they are talking about means that
17 in a situation, if a grandfather gives a gift to a
18 grandchild, that there would be a double gift tax charged on
19 it. So if you had an 85-year old grandfather who wants to
20 give something, skip his 65-year old son and skip his
21 45-year old grandson, and give a gift to his 25-year old
22 great-grandson, they would want to tax it three times.

23 I can't for the life of me believe that that is what
24 this Congress wants to do. It is not the intent of the
25 Congress, I don't believe, to do that, and I would just like

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1 to move that we repeal this generation-skipping tax right
2 now.

3 The Chairman. All right.

4 We would like to hear from Treasury briefly, then I
5 would like to vote on it, because we need to really move on.
6 There is no way we are going to resolve this; it is going
7 to take a vote. We have had it up a half a dozen times. And
8 I know Treasury has a different view. If we could hear that
9 in 30 seconds, we can vote on it.

10 Mr. Pearlman. I promise it will be 30 seconds.

11 I think Treasury's view has been and continues to be,
12 Mr. Chairman and Senator Symms, that if you are going to have
13 an estate tax, if there is going to be a transfer tax in
14 this country, then you make a joke out of it if you don't
15 have some limitations on the ability of donors and grantors
16 to skip generations. You simply have got to preclude a
17 father's ability to skip generations and pass a property on
18 to grandchildren and great-grandchildren. Otherwise, the
19 estate tax in this country is going to become a joke. And
20 that is basically what our concern is.

21 Senator Symms. But you want to tax them twice, though.

22 Mr. Pearlman. No, I don't think we want to tax them
23 twice. We want to make sure that there is a tax at that
24 generation. And I don't think that --

25 Senator Symms. No, there would be a tax. If you give

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1 a big gift to a grandchild, and there is a gift tax to be
2 paid, it would be paid on it.

3 And the way you are making this direct skip, you will
4 have it in here next year. People will be saying, "How
5 do we apply this?" You will have to charge each generation
6 with the tax. I don't think that is the intent. What if
7 the guy wants to give the estate down here to the local
8 bartender or somebody that he happens to like? So he wants
9 to give it to him, so it is one tax. But it happens to be
10 that the person he is giving it to is his grandchild. So
11 you want to charge two taxes.

12 Mr. Pearlman. Senator, I don't think that is accurate.

13 Senator Symms. It is accurate.

14 Mr. Pearlman. Well, let me --

15 The Chairman. You have had your 30 seconds. I don't
16 want to shut Treasury off, but you are not going to go to
17 China if we don't finish this.

18 Senator Symms. Mr. Chairman, I will say to my
19 colleagues, I will pledge, we will have a hearing on this
20 and take the Treasury's proposition up, and we will look at
21 it next year. But I would ask my colleagues, let's just
22 repeal this thing once and for all, and get it off our backs.

23 The Chairman. Well, let's vote on it.

24 The Clerk will call the roll.

25 Mr. DeArment. Mr. Packwood?

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- 1 (No response)
- 2 Mr. DeArment. Mr. Roth?
- 3 (No response)
- 4 Mr. DeArment. Mr. Danforth?
- 5 Senator Danforth. Aye.
- 6 Mr. DeArment. Mr. Chafee?
- 7 (No response)
- 8 Mr. DeArment. Mr. Heinz?
- 9 (No response)
- 10 Mr. DeArment. Mr. Wallöp?
- 11 The Chairman. Aye. Wallop votes Aye.
- 12 Mr. DeArment. Mr. Durenberger?
- 13 (No response)
- 14 Mr. DeArment. Mr. Armstrong?
- 15 Senator Armstrong. Aye.
- 16 Mr. DeArment. Mr. Symms?
- 17 Senator Armstrong. Aye.
- 18 Mr. DeArment. Mr. Grassley?
- 19 The Chairman. I think he is in the back room. We'll
- 20 get him.
- 21 Mr. DeArment. Mr. Long?
- 22 (No response)
- 23 Mr. DeArment. Mr. Bentsen?
- 24 (No response)
- 25 Mr. DeArment. Mr. Matsunaga?

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1 Senator Matsunaga. Aye.

2 Mr. DeArment. Mr. Moynihan?

3 (No response)

4 Mr. DeArment. Mr. Baucus?

5 Senator Baucus. Aye.

6 Mr. DeArment. Mr. Boren?

7 Senator Boren. Aye.

8 Mr. DeArment. Mr. Bradley?

9 No.

10 Mr. DeArment. Mr. Mitchell?

11 (No response)

12 Mr. DeArment. Mr. Pryor?

13 Senator Pryor. Aye.

14 Mr. DeArment. Mr. Chairman?

15 The Chairman. Aye.

16 Senator Grassley is here.

17 Senator Grassley. Aye.

18 Senator Bradley. Mr. Chairman, the vote is to repeal

19 the generation-skipping?

20 The Chairman. Right.

21 Mr. DeArment. To repeal the generation-skipping tax.

22 The Chairman. The Yeas are 10, the Nays are one. The

23 amendment is agreed to. The record will remain open, and

24 we will see how many changes we have.

25 (Laughter)

1 The Chairman. Let's see how good Treasury is.

2 (Laughter)

3 The Chairman. You ought to hire the realtors, and you
4 can get it turned around.

5 (Laughter)

6 The Chairman. What about the foreign tax credit?

7 Senator Baucus. Mr. Chairman, do you want to take
8 Number 7?

9 The Chairman. Oh. Excuse me. I didn't want to over-
10 look this technical amendment on copper, zinc, and lead
11 Superfund tax.

12 Senator Baucus. Mr. Chairman, it is Number 7 on the
13 list. I understand the committee this morning adopted a
14 similar amendment with respect to oil.

15 This is to credit a problem that now exists in the
16 Superfund Act, which imposes a tax on the sale or use of
17 about 40 different specific chemical compounds.

18 Very briefly -- I think most Members are familiar with
19 the problem -- the tax is intended on certain compounds, but
20 it is not intended to be a tax on copper, lead, or zinc.

21 In the present process of smelting these metals,
22 compounds such as cupric sulfate and others do transitorially
23 occur during the smelting process; but then they virtually
24 vanish or disappear -- that is, there is no byproduct here
25 that is a product that ordinarily should be taxed in

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1 Superfund.

2 So this amendment, Mr. Chairman, is essentially to
3 cure this problem. The Commerce Department, the Interior
4 Department, and I understand the Treasury also agrees with
5 my amendment but felt constrained to issue regulations
6 opposing the tax because of just the way they interpret
7 the law; but they agree as a matter of public policy that
8 the amendment I am offering makes sense.

9 The problem is that the present tax does apply, as I
10 said, to compounds which do occur during the smelting
11 process but then do vanish; there is no byproduct here, no
12 product that the Superfund Tax is intended to reach.

13 Second, the result as attributed by the Treasury in the
14 past contravenes Congress's intent to exempt the production
15 of copper, lead, and zinc metal. That intent has been very
16 clear in the past, but the effect of this interpretation by
17 the Treasury is to tax those metals, directly contrary to
18 the intention of the Congress. And there is much
19 legislative history which supports that.

20 Beyond that, the Treasury's past interpretation very
21 directly favors imported metals, particularly copper, at the
22 expense of domestically-produced copper, lead, and zinc,
23 basically because of this additional tax.

24 This amendment is clearly, undeniably a technical
25 amendment. It is a clarification amendment. It is revenue

1 neutral, because there is no way in the world that Congress
2 intended to pick up revenue from this compound which, as I
3 said, is a product of the smelting process which during the
4 process, later on in the process, disappears. It is not
5 a byproduct problem and wasn't intended to be covered by
6 Superfund legislation.

7 And as I said earlier today, this committee has adopted
8 similar clarification, a similar technical amendment with
9 respect to oil. That is my understanding, anyway. This is
10 the same amendment. It is ever more clear. It is more
11 technical, and it has even less of an adverse effect.

12 The Chairman. Could I ask the Joint Committee and
13 Treasury, I think Senator Bradley wants to be heard, but
14 do you agree that it is a technical amendment?

15 Mr. Pearlman. Yes, we agree it is a technical
16 amendment. We do not oppose the amendment.

17 The Chairman. Do you support the amendment?

18 Mr. Pearlman. Yes, we support the amendment.

19 Senator Bradley. The Administration supports the
20 amendment?

21 Mr. Pearlman. Senator Bradley, we looked at the
22 legislative history, and we very recently had hearings on our
23 proposed regulation, which took a contrary view. We have
24 examined the legislative history; we received testimony at
25 that hearing; and we are persuaded that Senator Baucus's

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1 position correctly reflects the Congress's intent.

2 Senator Bradley. Well, even though the law specifically
3 states these compounds shall be taxed, and the legislative
4 history that you referred to is a statement put in the
5 record after the bill was passed, I would have to make the
6 same objection and the same argument today. This morning
7 we backed the truck up to the Superfund vault and unloaded
8 it into the pockets of the refiners. And today we are
9 backing it up to the Superfund vault and unloading it into
10 the pockets of the lead smelters and the copper smelters.

11 You know, at some point we are going to have to decide
12 whether we are going to spend money to clean up toxic
13 wastes. It seems to me that both of these, if there is
14 merit, if there is legislative history, should have been
15 dealt with in a reauthorization of the Superfund.

16 There is no one in this room or in this city or in
17 this country that believes that toxic wastes are going to
18 be cleaned up by 1985 when that law expires. And somehow
19 we are going to have to pay for it. And if we are going to
20 be true to the intent of the Superfund law, there are going
21 to be higher taxes on these chemicals, because they are the
22 problems.

23 I understand that the train is leaving, and sometimes
24 we all want to jump onboard, and I understand that. But
25 I really think that it is the wrong place to do this. There

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1 might be merit in some of these points, but I guarantee you
2 that it is going to be pretty tough to revisit them after we
3 get the committee already on record.

4 And the Treasury this morning was not even able to tell
5 me how much money is in the Superfund account. Do they know
6 now how much money is in the Superfund account? The
7 argument is, this won't effect the amount of money, "we are
8 going to have \$1.38 billion by 1984." Well, how much do
9 we have now? They can't answer that question.

10 So, Mr. Chairman, I know the votes, but I will call for
11 a rollcall on this. I would like to definitely be recorded
12 as not attempting to gut the Superfund law. And I think it
13 is surprising that the Administration took that position.

14 Mr. Stretch. Mr. Chairman, in response to your
15 question, the joint staff also takes the view that this is
16 a technical amendment if it is limited to the compounds which
17 exist in a transitory state during metal processing, and it
18 has no application to anything which is removed from the
19 processing plant.

20 The Chairman. That's what Senator Baucus says.

21 Senator Baucus. That's true, that is the understanding.

22 The Chairman. It does limit it, then?

23 Senator Baucus. It does limit it to those transitory
24 compounds. That is correct.

25 The Chairman. Does that resolve your question?

1 Senator Bradley. No, it doesn't. I would like to have
2 a vote on this issue in the Finance Committee.

3 The Chairman. Do you have confidence in the Joint
4 Committee and the Treasury.

5 Senator Bradley. I have confidence in the Joint
6 Committee. On revenue estimates, they have given me a very
7 good revenue estimate on how much we can save if we go back
8 to the pre-1981 Depreciation Law, as well as giving a whole
9 series of other revenue assessments. I have the greatest
10 respect for the Joint Tax Committee in their nonpartisan
11 revenue estimates, which I think are highly professional,
12 and I think we are lucky to have such an outstanding group
13 of individuals to serve the Congress of the United States
14 when it comes to revenue estimates.

15 (Laughter)

16 Senator Bradley. But we are not dealing with that
17 question now. We are dealing with the question of whether
18 we are going to gut the Superfund, and we are going to be
19 revisiting it sometime in this committee.

20 In 1980, this committee essentially passed it out with-
21 out any question.

22 The Chairman. I voted for it.

23 Senator Baucus, I think you are ahead, so move quickly.

24 Senator Baucus. I want to nail this down, though,
25 because the fact of the matter is, there is committee report

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1 language before this bill was even acted upon which very
2 clearly states that the Superfund legislation is not intended
3 to cover these compounds.

4 Let me just read from the EPW Committee Report dated
5 June 11, 1980:

6 "The fee is to be imposed only on these three sulfur
7 compounds when they are sold by a supplier to any other
8 person or used onsite to produce other materials besides
9 copper metal." I mean, it is clear that this fee is not to
10 apply to transitory metals.

11 Senator Bradley. Well, what about lead smelting? Does
12 it say "lead smelting" there in that report?

13 Senator Baucus. I agree we should have a strong
14 Superfund bill. You know, I am very strong for Superfund
15 legislation. And the fact of the matter is, I think it is
16 unfair and inappropriate to characterize this as "gutting
17 the Superfund," because it is nowhere close to gutting the
18 Superfund. It is a technical clarification. The language
19 clearly states in the legislative history that it was not
20 intended to cover this situation; that is all I am trying
21 to clear up here.

22 I think that, Yes, we can address Superfund problems
23 later; but here is one technical clarification of the law
24 that everyone agrees -- except the Senator from New Jersey,
25 apparently -- that everyone else agrees is the legislative

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1 that it is clear should be corrected at this point.

2 Senator Bradley. That's right. I am ready for the
3 vote.

4 The Chairman. Well, let me suggest that --

5 Senator Bradley. Mr. Chairman, may I ask you a
6 question before we leave this subject? Do you expect that
7 we will be addressing the reauthorization of the Superfund
8 in the next several months in this committee?

9 The Chairman. Yes.

10 Senator Bradley. Do you think by May?

11 The Chairman. By May?

12 Senator Bradley. Yes.

13 The Chairman. We may still be on this by May.

14 (Laughter)

15 Senator Bradley. If I felt that we were indeed going
16 to get to a reauthorization of this bill, and we were going
17 to do it this year, that is very important; because we will
18 be revisiting each one of these issues, and we are going to
19 have to get a lot more money than \$1.3 billion if we are
20 going to clean up those wastes. So somebody is going to have
21 to take it.

22 The Chairman. Well, I am not unwilling to start
23 addressing it any time. I am not certain we will get to it
24 quite that soon.

25 Senator Bradley. By what date would you say?

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1 The Chairman. What about July?

2 Senator Bradley. Do you mean after the conventions?

3 The Chairman. During the conventions.

4 (Laughter)

5 The Chairman. Yours.

6 (Laughter)

7 Senator Bradley. Well, there will be more interest
8 at that point.

9 The Chairman. No. We will try to work it out. I
10 don't know what the schedule is, but obviously we have to
11 address it, and you are right -- we have to find the money.
12 I don't think Senator Baucus objects to finding the money

13 Senator Baucus. No, not at all.

14 Senator Bradley. Well, he only objects to putting the
15 tax on anything that would give you the money. I mean,
16 we all want to find the money; we are all for Superfund.
17 So let's vote and make sure we have a recorded vote on this
18 one.

19 The Chairman. All right. Let's call the roll.

20 Mr. DeArment. Mr. Packwood?

21 (No response)

22 Mr. DeArment. Mr. Roth?

23 (No response)

24 Mr. DeArment. Mr. Danforth?

25 Senator Danforth. Aye.

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

- 1 Senator Boren. Aye.
- 2 Mr. DeArment. Mr. Bradley?
- 3 Senator Bradley. No.
- 4 Mr. DeArment. Mr. Mitchell?
- 5 (No response)
- 6 Mr. DeArment. Mr. Pryor?
- 7 (No response)
- 8 Mr. DeArment. Mr. Chairman?
- 9 The Chairman. Aye.
- 10 On this vote there is one Nay, and how many Yeas?
- 11 Mr. DeArment. Eight.
- 12 The Chairman. Eight; and again the vote is open.
- 13 All right, let's go to 20, foreign tax credits.
- 14 Dave, do you have anything on foreign tax credits?
- 15 Whose amendment is that?
- 16 Mr. Brockway. This is the proposal of Senator Danforth.
- 17 I understand it would be comprised of two parts dealing
- 18 with taxpayers who have U.S. losses in an early year that
- 19 reduces their foreign tax credit because it reduces their
- 20 total tax liability, and then in a later they have U.S.
- 21 source income and they aren't allowed to claim the excess
- 22 foreign tax credits generated by their early-year loss
- 23 against their tax liability attributable to their foreign
- 24 operations in a later year.
- 25 The proposal would do two things, I understand, in the

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1 present form -- one would apply a domestic loss recapture
2 rule similar to the ones we have, where you have a foreign
3 loss recapture rules that were adopted in 1976. This would
4 also apply a mirror system where there are losses in the
5 U.S. on a prospective basis. It would also extend the
6 carry-forward period on the excess foreign tax credits from
7 5 years to 10 years.

8 That proposal would have a revenue impact, a loss of
9 about --

10 (Continued on next page)

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1 The Chairman. A loss or a gain?

2 Mr. Brockway. A loss of about \$550 million over the
3 1984 and 1987 period.

4 The Chairman. Could the Treasury comment on this? I
5 didn't know it was that expensive.

6 Mr. Pearlman. Mr. Chairman, I understood there were
7 three pieces to the proposal. And the first piece, the part
8 that Mr. Brockway refers to the recapture rule, has
9 undergone -- we have undergone some discussions with Senator
10 Danforth and his staff, and depending on what the specific
11 terms of the proposal are, we most recently would suggest
12 that the proposal have an effective date for taxable years
13 beginning after December 31, 1984, in which case--and there
14 are certain limitations on the amount of the loss that is
15 available--the revenue loss goes down. It is still
16 significant, but it goes down to \$330 million over the period
17 1985 through 1987.

18 Our position on this proposal has been, on the first
19 piece of the package, that we agree in principle with
20 Senator Danforth's proposal. We have expressed concern about
21 the significant revenue loss, and have sought to work with
22 him in reducing that loss.

23 I hope we would have an opportunity to comment on the
24 other two pieces of the proposal separately because they have
25 different revenue impacts and different rationale.

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1 The Chairman. Yes. I am not certain what the fate of
2 this provision may be if it is that expensive, but are there
3 ongoing discussions now with Senator Danforth or can be
4 ongoing?

5 Mr. Pearlman. It certainly can be, sure.

6 Mr. Brockway. There are two alternative approaches to
7 reduce the revenue. One is to delay the effective date.
8 Obviously, the later you make it the less it would lose in
9 the window. And the alternative is to look at other
10 proposals that would be offsetting revenue gainers in the
11 international area.

12 The Chairman. Let's try to discuss that. We are going
13 to leave here soon. Maybe we can discuss it. Treasury can
14 get together with Senator Danforth.

15 Are there any other items on this list that we might
16 be able to dispose of very quickly? Is that all right, Jack?

17 Mr. Brockway. That's fine.

18 The Chairman. All right. Senator Grassley.

19 Senator Grassley. We can take care of this one on the
20 penalty. We have got that worked out.

21 The Chairman. Which number is that?

22 Mr. Pearlman. That is the estimated tax, item 4.

23 The Chairman. Oh. Right.

24 Senator Grassley. I don't even see it on here.

25 Mr. Pearlman. Number 5.

1 The Chairman. Oh, that is right. I guess we agreed,
2 unless you objected, that it be approved.

3 Senator Grassley. Well we have got it worked out.

4 The Chairman. All right.

5 Mr. Pearlman. So we will just scratch that one.

6 The Chairman. It has been worked out. We didn't put
7 it back on the agenda because we understood if it is worked
8 out with Senator Grassley and Treasury, everybody else agreed
9 that it should be.

10 You have got it worked out, Rod?

11 Mr. DeArment. Yes.

12 The Chairman. Good.

13 What about anything on this list, Rod or Dave?

14 Modifications. The straddle rule. That is going to be
15 tomorrow. Buck and Senator Packwood are still talking about
16 VEBAs. What is the exception to estimated tax payment
17 requirements?

18 Mr. Pearlman. That is the one that Senator Grassley
19 just reported to you.

20 The Chairman. Oh. That is finished then.

21 Mr. Pearlman. That is finished, right.

22 The Chairman. Oh, good.

23 Are you getting information on the de minimis rule?

24 Mr. Brockway. We are trying to find information on
25 that, how much is involved. It is not going to be an easy

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1 process there because, one, in a number of cases, the returns
2 may not have been filed. And there have been about eight
3 people that have come to see us involving, in some cases,
4 more than a million dollars of tax liability. But I don't
5 think we have any hard numbers on that.

6 The Chairman. It would seem to me that Treasury would
7 take a look at it. As I understand, 1973 is when people were
8 really put on notice. Is that correct?

9 Mr. Brockway. That is correct.

10 Mr. Pearlman. Yes. The ruling was published in 1971.

11 The Chairman. Well why don't you start from 1973 and
12 work forward? I mean, why would you want to go back?

13 Mr. Brockway. I think that virtually all the cases would
14 be after 1973. The difficulty is that you wouldn't have it
15 appearing on the return. The taxpayers probably were not
16 taking the position that it was a taxable gift, and so that
17 it doesn't show up in their processing system.

18 Even if it did show up, they probably wouldn't list them
19 now. They would just file a return and note that there was
20 a loan. So they probably do not have good data on it.

21 The impact would be both those taxpayers that filed a
22 return and also I think the lion's share of the case would
23 be taxpayers who did not report it as a gift, but will have
24 to under the Supreme Court's decision.

25 The Chairman. All right. Well I do think we need

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1 additional information. As I understand, there is some very,
2 very substantial loans in this case, gifts, whatever.

3 Mr. Pearlman. Well there are. We are trying to get some
4 information on the number of the examinations, but we know
5 that there are a number of examinations involving this issue
6 pending that will be affected. We are going to try to have
7 some data for you tomorrow.

8 The Chairman. All right. So we still have to open it
9 so we can still make, Rod, a new 10:00 o'clock agenda.

10 Mr. DeArment. We have part of number 1.

11 The Chairman. Part of number 1.

12 Mr. DeArment. Number 2, number 3.

13 The Chairman. Number 5.

14 Mr. DeArment. Number 5. Part of number 6, but most of
15 it we have taken up.

16 The Chairman. Just minor provisions in number 6.

17 Mr. DeArment. That is right.

18 Number 9, 10.

19 The Chairman. Number 9 and 10.

20 Mr. DeArment. Eleven.

21 The Chairman. Eleven.

22 Mr. DeArment. Twelve.

23 The Chairman. No. Twelve is finished, depending if, in
24 fact, they can reach some agreement. I agree with Treasury
25 on that if they can work it out with Senator Durenberger.

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1 Mr. DeArment. All right.

2 The Chairman. I understand 13, Church audits, will be
3 completed shortly after we -- there is going to be a meeting
4 with Senator Grassley.

5 Senator Grassley. Yes.

6 The Chairman. And we can work that out.

7 Fourteen is complete. Fifteen is complete. Sixteen, 17,
8 18. Why don't we bring up 18. That is Senator Garns that
9 I understood would be hardly any revenue at all. Now I
10 understand it is \$100 million a year.

11 Mr. Pearlman. This morning we met with Senator Grans,
12 Mr. Chairman, and reviewed his proposal. There were some
13 changes made in legislation that he had submitted earlier.
14 We are running revenue estimates on those changes and we will
15 have them for you tomorrow morning. We do not have them now.

16 The Chairman. Is there going to be substantially less
17 revenue?

18 Mr. Pearlman. I doubt it, but I just don't know.

19 Mr. Brockway. His earlier proposal was about \$300 million
20 a year.

21 The Chairman. You mean over three years, I think, wasn't
22 it?

23 Mr. Pearlman. Well David is correct. It began at \$300
24 million a year, and then because of changes that Senator Garns
25 and his staff had made, it dropped to somewhere in the \$125 or

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1 so million a year. And I think now it is around \$300 million,
2 subject to the conditional changes. I think that is
3 correct.

4 The Chairman. We have a lot of watches.

5 (Laughter)

6 The Chairman. It can be hard on somebody who doesn't get
7 their act together here pretty soon. We are losing revenue
8 and somebody is going to have to pay for it later.

9 Are you picking up the revenue losers?

10 Mr. DeArment. We have a revenue loser line and we just
11 lost some revenue. The luxury cars are down again.

12 (Laughter)

13 The Chairman. What happened?

14 Mr. DeArment. Senator Boren voted "present". He had
15 previously voted "aye". So it is now a tied vote, eight to
16 eight. And in that event it loses.

17 Senator Grassley. What is the title?

18 The Chairman. Luxury cars.

19 It was a dead heat, right?

20 Mr. DeArment. A dead heat.

21 The Chairman. Well it will change, I'm sure.

22 (Laughter)

23 The Chairman. All right. Now anything else that we can
24 slip in here?

25 Mr. DeArment. Twenty, 21 and 22 are all still open issues.

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1 The Chairman. What is the cost of 22, Volunteer Mileage?

2 Mr. DeArment. As I understand, it is around \$300 million
3 over the period. Is that right, Dave?

4 Mr. Brockway. I believe that is correct.

5 The Chairman. Does Treasury oppose that?

6 Mr. Pearlman. Treasury opposes that proposal.

7 The Chairman. For what reason?

8 Mr. Pearlman. What the Senator wants to do is increase
9 the mileage allowance from the current nine cents to 21
10 cents. And what that does is bring in the depreciation of an
11 automobile into the charitable deduction. That is a
12 departure from prior law, and we propose it for that reason.

13 The Chairman. What do you have in the House bill,
14 anything?

15 Mr. Pearlman. No. There is nothing in the House bill.

16 The Chairman. Well Senator Armstrong might take that up
17 in the morning. All right. So we have about maybe seven or
18 eight items here which we should finish. And then we have
19 another list and not any more add-ons. We have got to go
20 back and find some money now.

21 What would we move to next then?

22 Mr. DeArment. We could move to some revenue raisers.

23 The Chairman. Do you have any in mind?

24 Mr. DeArment. Yes.

25 The Chairman. Is that that large catalog there? Would

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1 you get an estimate on the portion that we did agree with;
2 the one for Senator Grassley on the syndicates?

3 Mr. DeArment. We have an additional revenue raiser list;
4 extension of time value of money rules to deferred rentals;
5 a related party rule for Section 2652; a zero coupon rule on
6 municipal bonds. That is in the Ways and Means Committee
7 bill.

8 A redefinition of earnings and profits; a Treasury
9 dividends received deduction holding period proposal; and
10 offsetting position rule; expansion of the committee's
11 compliance provision on dividends received deductions to
12 other cases; use of related party structure to reduce tax on
13 coal operations; and foreign collapsible corporation
14 provision.

15 The Chairman. All right. And some of the others are
16 still in the negotiation stage?

17 Mr. DeArment. Yes. We have still the real estate.

18 The Chairman. Are you getting closer on the real estate?

19 Mr. DeArment. I think so. I have to go over where the
20 Treasury Department is, based on their meetings that they
21 had yesterday.

22 The Chairman. We are getting closer. I wondered if they
23 were getting closer. Maybe we will just have to vote on a
24 number of options and see what happens.

25 Are there any other technical things that we can discuss?

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1 I don't have a quorum right now, but any technical items
2 that we have had to go back and correct or want to raise
3 questions on?

4 (No response)

5 The Chairman. And I assume you are drafting. Is
6 somebody drafting as we go along?

7 Mr. DeArment. Yes, Mr. Chairman.

8 The Chairman. So that if we do finish we will be in
9 pretty good shape.

10 Well apparently Senator Packwood and Buck have gone to
11 dinner.

12 (Laughter)

13 The Chairman. So we will recess until 10:00 o'clock
14 tomorrow.

15 (Whereupon, at 5:07 p.m., the session was recessed, to
16 reconvene at 10:00 a.m., Wednesday, March 14, 1984.)

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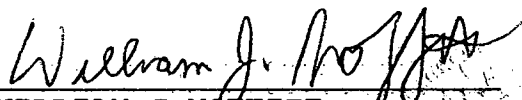
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C E R T I F I C A T E

1
2 This is to certify that the foregoing proceedings
3 of a mark-up session of the Senate Committee on Finance,
4 held on March 13, 1984, in re: budget deficit reduction
5 proposals, were held as herein appears and that this is the
6 original transcript thereof.
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11 
12 WILLIAM J. MOFFITT
13 Official Reporter

14 My Commission expires April 14, 1984.
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