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COMMITTEE ON FINANCE

UNITED STATES SENATE

EXECUTIVE SESSION

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EXECUTIVE SESSION

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THURSDAY, OCTOBER 6, 1983

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United States Senate

Committee on Finance

Washington, D. C.

The Committee met, pursuant to notice, at 10:33 a.m., in room SD-215, Dirksen Senate Office Building, the Honorable Robert J. Dole (Chairman of the Committee) presiding.

Present: Senators Dole (presiding), Roth, Chafee, Armstrong, Symms, Grassley, Long, Bentsen, Matsunaga, Moynihan, Baucus, Boren and Bradley.

Staff Present: Mr. DeArment, Mr. Stern, Mr. Belas, Mr. Wetzler, Mr. Stretch, Mr. Pearlman, Mr. Weiss, Mr. Rollyson, Mr. Hardee, Mr. LeDuc, Mr. Susswein, and Mr. Graham.

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The Chairman: Again I apologize to all those people in the hall. I assume we have sound. It is easier to get a ticket to the World Series or the playoffs than it is to the Finance Committee markup. I don't know what the interest is here but I apologize.

Senator Moynihan: Mr. Chairman, we are going to be talking about medicaid, aren't we?

The Chairman: Right. Some of those programs. I regret that we don't have a larger hearing room and I apologize that we don't have chairs in the hallway. If anyone feels faint, we will do something.

(Laughter.)

The Chairman: You probably will feel faint after we go over the agenda. I think what we might do today and again there will be no votes today. We are still working on the public leasing. The House is about to complete action. Very honestly we would like the House to at least at a committee level complete their action before we start making decisions. We are going to have to ask for an extension of the October 17 date, Is that correct?

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

The Chairman: We understand Senator Roth will object to that which simply means we will have a vote. We will probably ask for an extension until the end of the month. When we return we will start taking votes and see if we can put together a package. There is always the hope that the White House may be listening and may be willing to address the deficits by the time we return next week.

The Treasury secretary seems to be reducing them just in speeches so maybe by the time we get back, there won't be any deficit.

(Laughter.)

The Chairman: If there is, we will have to face up to it.

Let's just go down starting with the other reconciliation revenue options, the life insurance taxation. Again I don't think we need to spend a great deal of time. As I understand the House action on life insurance amounts to about a billion and a half dollar tax cut over three years. It may be that the Senate wouldn't do anything. We lose less money by doing nothing, is that correct?

Mr. Belas: That's correct, Mr. Chairman. The House bill would over a three-year period lose compared to present law approximately a billion and a half dollars. If the TEFRA temporary provisions, the so-called "stop gap" provisions, were allowed to expire for budget purposes, there would be no revenue loss.

Senator Moynihan: Mr. Chairman, I am over my head in the technicalities here. The present law was enacted in 1969?

Mr. Belas: In 1959.

Senator Moynihan: In 1959. Is it not the case that if we allow simply the TEFRA provisions to expire, we go back to the pre-1959 legislation?

Mr. Belas: We go back to the 1959 legislation, the 1959 legislation. What was accomplished in TEFRA were two things essentially. One, the Congress repealed the modified coinsurance special tax treatment, the so-called "modco" loophole and also enacted effectively a tax cut on a temporary two year basis to the life insurance industry partially to make up for the loss of "modco" on a temporary basis.

Senator Moynihan: We are going to go through each of these things and we can look at what the effect of the lapsing of the TEFRA will be in going back to the 1959 legislation. I think it is important to learn that we are cognizant that the House provision would reduce revenues. That is not what we are doing here.

The Chairman: As I understand the industry has no quarrel at least in my visits with different groups with maintaining what we thought we would receive under the action taken in TEFRA but I guess in the process because of some things I don't understand the impact the House bill would be to in effect to reduce taxes substantially.

Mr. Belas: Mr. Chairman, last year the revenue estimate for 1984 when the so-called stop gap legislation would expire was anticipated to be $4.7 billion dollars of revenue from the industry. Current estimate from the joint committee is that expiration of TEFRA would only bring $3.3 billion dollars in revenues from the life insurance industry while Treasury thinks it may be $3.8. That is substantially less than was estimated last year when TEFRA was enacted.

The Chairman: Do I understand correctly it is not the revenue -- it may be in part the revenue that concerns the industry. It is a question of whether it is going to impact on stocks or mutuals or whatever.

Mr. Belas: That is correct, Mr. Chairman. The mutual companies are -- it may be argued on what basis you make the comparision, but the mutual companies and the stock companies are roughly comparable in the amount of business, the amount of assets. The mutuals have a slight edge. The Stark-Moore proposal which went through the Ways and Means Committee yesterday would put a 55 mutual/45 stock company split within the industry. That was a very hotly contested issue over on the House side this year.

Senator Moynihan: If I may say, Mr. Chairman, New York has many of these companies so I have some information about it. The group of companies that were sort of representing the mutual industries indicated their willingness to accept the apportionment, 55/45, even though they obviously would like it to be more in their favor. But they accepted that apportionment and that might have something to do with the fact that it involved a tax cut anyway.

Mr. Belas: That is understanding, Mr. Chairman.

Senator Long: Might I just suggest, Mr. Chairman, that this is a very significant item. The House spent a long time working on their bill. Might I ask the staff how much time did the House spend working on this measure?

Mr. Stretch: Senator Long, the House started with the staff at the beginning of February.

Senator Long: February?

Mr. Stretch: Yes, sir.

Senator Long: How many months does that make it?

Mr. Stretch: That would be about nine months now that has gone into it.

Senator Long: So the House spent nine months working on this measure. I have been hearing about it right along. People would come to me and I am sure that they came to other members on the committee and told us what the House was doing and what they were trying to work out with the House and the ways that they thought this issue could be resolved, but if the House spent that much time working on it I am sure they did it because it is complex. It required a great deal of thought. So they will have done the best they can to work out a difficult problem.

I just think, Mr. Chairman, that we ought to take enough time in this committee to where we understand thoroughly what we are doing and I like to think that just as they have the capacity to improve on their own handiwork we have a capacity to improve on what comes to us. I just would hope that we will take the time to do justice to this matter and to use whatever imaginative genius we have in our committee and in the Senate. That takes some time. I don't think we can do it in what remains to us of this session. I just don't see the time available.

The Chairman: I think I am correct but I will ask. All that time the House was spending, we were also engaged in that through staff. It is not that we haven't been working on it on the Senate side.

Mr. Belas: That is correct, Mr. Chairman.

The Chairman: I know that it is a very controversial issue dealing with large companies, a lot of diversification. In fact, it was last year that we worked out the agreement with the industry to their satisfaction on the Senate side. I don't think there is any dispute with the industry. At least we are not looking for any dispute. It is a question of how you come down and how you make it fair for stocks, mutuals whatever. Some have different problems.

I think the one point that is of some concern based on representations by the industry is if in fact the House bill reduced revenues by a billion and a half dollars, then we need to take a rather -- it didn't when it started but by the time they finished it was. The way they satisfied everybody was by eliminating a lot of the revenue. That is not too hard to do.

Mr. Belas: Mr. Chairman, last year you asked the staffs of the Finance Committee and the Joint Committee to prepare a report of various issues and possible options that might be pursued by the committee after the expiration of the TEFRA provisions. That report has come out within the last week. The committee of course has not yet held hearings on those possibilities on the staff report.

Mr. Wetzler: Mr. Chairman, one other thing that is not reflected in this write-up is yesterday the House agreed to an additional amendment to the insurance provision which I think is of interest to some members of the committee. This is a non-deductible IRA provision which is for people who filled up their $2,000.00 on their IRA or $2,250 in the case of spousal IRA's, they could make an additional contribution of up to $1,750.00 which while the contribution would not be deductible, the interest earned on that contribution would get deferred until the time the contribution is pulled out.

That is not reflected in these write-ups but it is going to be in the amendment to the House bill.

The Chairman: What is the revenue impact of that?

Mr. Wetzler: It is a few hundred million dollars a year when the thing gets phased in. It will start small and build up to that figure.

The Chairman: That is interesting. It will be a few hundred million more that we need to find. I think Senator Long is right. We are not asking anybody to make any judgment here. I think the record should reflect that there has been a lot of work by this staff and the joint committee staff in the past year and a half with the industry. I must say that they have been very helpful. If we can't work it out it isn't because the industry hasn't been willing. I think it is because we have different views within the industry. Hopefully, we can work that out.

Mr. Stretch: Mr. Chairman, the committee might like to know that your staff on both the majority and the minority staff were participants in the House staff level discussions and did make significant technical contributions to those deliberations. So they have been involved right along in watching what has gone on in the House side.

The Chairman: The next item is taxation of fringe benefits. What we have tried to do is just list things that have been raised in the committee and with the attachments some of the options. There may be other options. I know in this case one option of course has been suggested by Senator Maddingly and others we just defer for two additional years and extend the moratorium.

The House I guess did yesterday pass some kind of a fringe benefit proposal. Mr. Pearlman or Jim, are you there? What did the House do?

Mr. Wetzler: I will let Randy Weiss describe exactly. It is essentially what is listed here as the subcommittee bill.

Mr. Weiss: The Ways and Means Committee bill essentially tries to codify the tax free treatment of most existing fringes of the nature of providing employees the types of goods and services that the employer is selling to the public. So, for example, the practices of retain stores giving discounts to their employees and airlines giving free stand-by flights to their employees and so forth are made into statutory fringe benefits.

The Chairman: They didn't take those away. They just codified, right?

Mr. Weiss: That is basically what the thrust of the bill was.

The Chairman: As I understand those changes are supported by a lot of the employee groups. Is that correct?

Mr. Weiss: I believe that a lot of the employee groups and employer groups yes want the statutory protection of having these fringes specifically excluded from income in the code.

The Chairman: I know Senator Symms has another bill that deals with fringe benefits. I am not certain how it may compare.

Senator Symms: Why don't we have the staff tell the difference?

The Chairman: How does his bill differ from the action taken by the House? I think they may have accepted some of his provisions.

Mr. Weiss: The basic difference, I believe, is that the House generally requires as a condition of tax free treatment for a lot of these fringes a non-discrimination rule. That is, the highly compensated employees can't get the discounts or the free flights or whatever the property or service is that is being provided on more favorable terms than the rest of the employees. I believe that Senator Symms' bill does not have that rule in it. I think that is the basic difference.

The Chairman: Otherwise, they are essentially the same.

Senator Symms: Not quite. Isn't it a fact that what you would be applying say to somebody at Garfinckels who makes $15,000.00 per year and gets a 30 percent discount on clothes, they are going to have to pay taxes on it.

Mr. Weiss: No. They would not have to pay taxes on that under the Ways and Means Committee bill. The way the non discrimination rule works is that if the --

Senator Symms: If the management got a bigger discount than the retain clerk, you would?

Mr. Weiss: If the management got a bigger discount than the retain clerk, then the management would have to pay tax. The retail clerk would not have to pay tax.

Senator Symms: What about the senator that gets to use the gym and the AA who doesn't?

(Laughter.)

Mr. Weiss: There is already a provision in current law which says that in the case of a recreational facility that is primarily for the benefit of the highly compensated, that employers can't deduct the cost of that facility. So that was viewed as a sufficient non discrimination rule and what the bill contains is a corresponding rule that excludes from income the value of these athletic facilities.

Senator Symms: So you didn't answer my question though.

Mr. Weiss: It is excluded from income in the bill.

Senator Symms: It is not included?

Mr. Weiss: Right.

Senator Symms: How about if you are out here and you have company "XYZ" and they have a health facility for highly compensated?

Mr. Weiss: That is excluded from the income of the management but the employer cannot take a deduction for the costs attributable to that facility.

Senator Symms: Wait a minute. What if it disciminates of who gets to use it that works at the company?

Mr. Weiss: That is what my answer reflected.

Senator Symms: Then we should apply the same here, shouldn't we?

Mr. Weiss: That would be one change that could be made in the House bill if so desired. It is not in that bill.

Senator Symms: I don't understand.

Mr. Weiss: The rule is again that the value of the athletic facility is excluded from income regardless of who uses the facility regardless of what terms on which it is provided. However as under present law if it is primarily for the benefit of highly compensated employees, then the employer cannot take a deduction -- a tax deduction -- on his income tax with respect to that facility.

Senator Symms: Like the Treasury Department, for example, doesn't have the same kind of business rules as company "XYZ" out there where they could take a business deduction on an operation of a facility, parking lot or whatever for their employees.

Mr. Weiss: That is correct. Since non-profit organizations and governments are not affected by deductions, that they are not affected by that present law rule.

Senator Symms: So in other words Washington, D. C. would not be hit by this provision but all of the rest of the country would be.

Mr. Weiss: To the extent that there are more governmental and non-profit organizations in Washington, D. C., yes.

Senator Symms: How many millions of Americans are going to be affected by the Ways and Means Committee bill and have to pay more taxes as a result of it, 15 to 20 million?

Mr. Weiss: Essentially, Senator Symms, we think that very few tax payers would be affected by the Ways and Means Committee bill because it attempts to codify most of the existing practices under which these fringes are treated as tax free.

Senator Symms: What is the enforcement procedure going to be? How are they going to enforce it? Let's say you have 25 employees and five parking spaces. Who gets the five parking spaces? Do you go on a lottery? Do you by the person who has worked for the company the longest length of time or do you by the person who is deemed by the management as the most valuable? Do they pay taxes because they got a parking space and somebody else didn't?

Mr. Weiss: The bill says that the free parking is excluded unless it is given out on the basis that it is preferential to the highly compensated employees. If that is the case then those highly compensated employees would pay tax on the value.

Senator Symms: How is the IRS going to enforce that?

Mr. Weiss: They would come in and look at the way in which the parking spaces are given out to employees?

Senator Symms: If the IRS has so many people that they can go around and look into who is parking where it just seems like that is an awfully hard way to try to raise money for the government. I don't think it is worth all the hassle. I think this thing will come back and bite us if it does pass and become law when all the little places in the country that have more employees than they have parking spaces start having to fill out forms of who gets to park there and why. That is what you are really saying, aren't you?

What about the president of the company? He is not entitled to a parking space or the principal stockowner, the risk taker?

The Chairman: He has a helicopter pad.

Senator Symms: He has a helicopter pad?

The Chairman: Yes.

Mr. Weiss: Again it would just have to be looking at the basis on which these spaces are given out. I should also add that these rules are similar to rules which already apply in a wide variety of the statutory fringe benefit areas, pension and other things.

Senator Symms: Mr. Chairman, I just have to say I think that if we put this in, I mean there is such a thing as rough justice that takes place in this country on who gets to park in the parking lot. What we are saying is that Washington knows best of who should get to park there. If you decide and you are running the company and you decide that you have ten parking spaces and 25 employees, you pick out which ten people get it. I think we are not going to raise any money in the first place. It won't be enough money to flag a bread wagon for the Treasury but yet it is going to raise the hackles of people all across this country. I just don't think it is worth the effort. It is just another example. This thing has the potential to come right back and bite us like bank withholding unless we want to apply it in Washington.

The Chairman: Could we hear from Treasury on this?

Senator Symms: I just asked the question. Do you have parking places, you fellows with the joint tax committee?

Ask the senators here. We all have so many parking places and I think we discriminate on who gets them.

Mr. Wetzler: Some members of our staff do. I personally walk to work and I think Randy takes the subway.

Senator Symms: You are making my point. You are exactly making my point. There is a discriminatory decision made on who gets the parking space. If we are going to apply this to the private sector, it should be applied right here on Capital Hill for starters.

Senator Long: I agree with you, Senator. Nobody should have a parking space unless everybody has a parking space.

Senator Bentsen: You have really gone to meddling now.

Senator Symms: You are asking the IRS to do something that is not even realistic. In my opinion, Mr. Chairman, we ought to take this out of this bill.

The Chairman: We are not really asking anything. We are just trying to decide what we want to do in this area. I don't think Treasury is too anxious to get into this area, are you?

Mr. Pearlman: Mr. Chairman, I think it is clear that Treasury is reluctant to get into the whole area of fringe benefits. But nevertheless, if there is a discrimination rule in a final bill then hopefully the Internal Revenue Service will apply a non discrimination test on a rough justice basis. I would hope that the regulations and the rules that are issued to examining agents in connection with parking, for example, will be the kind that do permit people to function without unnecessary intrusion by the government. I would presume those people who are concerned about discrimination are concerned about things like corporate aircraft and some of the other fringe benefits that over the years have been applied.

Senator Symms: If that is the case though, wouldn't it be better just to leave it out of the bill?

Mr. Pearlman: I think that is a committee judgment. I don't want to express a view on that.

Senator Symms: Mr. Chairman, put me down on the side of leaving it out of the bill.

The Chairman. We don't have a bill.

Senator Armstrong: Could somebody just say who is it that advocates that the parking issue gets in the bill in the first place? Whose suggestion is that? Is anybody for it?

The Chairman. Where did it come from, Randy?

Senator Armstrong: If it doesn't have any parentage why don't we just drop it and get on to something that is more important. I probably think that Senator Symms is right. This is ridiculous for this committee or for the federal government to go around counting parking places and particularly to focus on it at a time when we have some serious business to do unless somebody really advocates it, let's go on to something else.

The Chairman: I think it properly belongs in the Department of Transportation.

(Laughter.)

The Chairman: Senator Roth.

Senator Roth: I apologize for not being here sooner but

I would like to if I may with your permission raise a broader question. I regret that as chairman of government affairs I haven't been able to attend all these meetings but what troubles me and this is a question that I would like to direct to the chairman of the committee as well as the Treasury people and that is, where are we going, what are we trying to do?

Are we really trying to raise taxes. I have read some things in leading periodicals and newspapers that there will be a major tax bill. Senator Dole, I am very much concerned what the purpose of these discussions are. We have a reconciliation before us. I hear that later on there may be a general tax bill. It appears to me that there is at least some thinking that the Finance Committee ought to construct a major tax bill.

I just would like to make the record very clear that five of us sent the chairman a letter recently or several weeks ago saying that we oppose any tax increase. I am speaking only for myself. I will let the other people who signed that letter speak for themselves. I am still opposed to any tax increase.

One of the questions I would like to hear from the Treasury is is the White House, is the Treasury now supporting a tax increase or not?

The reason there seems to be considerable momentum behind a bill to raise taxes is because of the horrendous deficit. I have to say that I am deeply concerned about the size of the deficits. I think they are a serious problem. I want the record to show very clearly that the raising of taxes has not succeeded in doing anything about the deficits. If anything, just the opposite.

A year ago I supported TEFRA with the Chairman and the Administration because the idea that we were going to raise taxes $95 billion dollars was going to have a major change on the deficit. The fact is that the tentative figures that were being given today shows that instead of cutting spending three dollars for every dollar that we raised revenue, we have raised spending $1.14 for every dollar of increased revenue.

So in fact as a result of TEFRA last year instead of cutting spending, instead of cutting the deficit, we have increased spending. I would just like to point out, Mr. Chairman, and this is a matter of critical importance to me, I would just like to point out that in the Wall Street Journal two days ago on October 4, it shows that the House Appropriations Committee has increased spending $24 billion dollars.

Everybody knows that if you increase revenue, you are going to increase spending. That has been the practice. That is the political fact of life. Yesterday we reported out of the Senate an appropriation in HEW four billion dollars over what the President proposed.

I think it is important that we have some idea of where we are going and what we are trying to do. I for one say that I am in no way going to support tax increases when all it results in is increases on the spending side.

I know that there are efforts being made both on the Hill and in the Executive Branch to increase taxes. Let me point out everybody points out the massive tax increases we have spelled out since the new Administration has taken over.

The Chairman: ~~Tax cuts.~~

Senator Roth: Yes. Tax cuts. ERTA, the Economic Recovery Tax Act of 1981, we cut taxes that year $1,138 billion dollars -- a lot of money. Let me point out that the tax increases since then amounts to $1,061 billion dollars so that the American people and American business are not enjoying a tax cut but in fact there is a net tax cut of $77 billion dollars.

In the last twelve months there has been inflation induced bracket creep of $489 billion dollars, 1977 social security tax rate increase of $214 billion dollars, TEFRA increased taxes, $281 billion dollars, gasoline tax increase, $21 billion dollars, social security, $56 billion dollars.

Senator Bradley: Did you say bracket creep was $489 billion dollars?

Senator Roth: That is the increase from 1981 through 1988. It will be $489 billion dollars over that period.

Senator Bradley: At what inflation rate?

Senator Moynihan: Is inflation coming back? We put 12 million people out of work to get of inflation but we haven't gotten rid of it.

Senator Bradley: We haven't even gotten rid of bracket creep.

Senator Roth: I have the Floor and I would like to complete what I am saying. What I am saying, ladies and gentlemen, is that there has not been any major tax increases because they have been offset by other -- tax cuts because they have been offset by tax increases. My real concern is that if we raise revenue further we are not going to reduce the deficit. The end result is going to be increase spending. That is demonstrated by the fact that the House appropriations has already increased spending beyond the President's budget by $24 billion dollars. Our record over here isn't that much better because yesterday we increased the HEW appropriation four billion dollars.

I just want to go on record as one senator that I am opposed to tax increases. Maybe there are some tax loopholes we ought to be shutting off but I would also say that I supported TEFRA last year. I supported withholding. I was told that was a closing of loopholes but the banks seemed to persuade the American people that it was a tax increase. I am concerned because American business, small business, Chamber of Commerce, NAM -- all of them have come on record against any tax increases. I would like to go back to my basic question at the beginning, Mr. Chairman, both to you and to the Treasury, is the Treasury, is the White House now supporting a tax increase? The other question I have is what is the intent or what is this committee supposed to be doing? What are the tax goals of this committee?

The Chairman: Let me respond first. I don't know what Treasury's view is. The Congress passed without my vote I must say and without the votes of 11 of the 20 on this committee a budget resolution. That budget resolution called upon this committee to come up with a tax package of $73 billion dollars. I opposed the resolution on the theory that it wasn't a balanced resolution. It wasn't the way to reduce deficits which was solely through taxes.

To show you how stark the contrast is we are only asking this committee over a three-year period to reduce spending by $1.7 billion dollars even though we have massive jurisdiction over hundreds of billions of dollars worth of entitlement programs.

To me, that is not an imbalance. I must say that we are trying to figure out how to meet that responsibility. We hope that there may be the votes on this committee when we get into voting, I think maybe starting on the 17th or 18th to cut spending more than we were asked to do by the Budget Committee. We are all going to have an opportunity to do that. In my view we can make further reductions in spending without having any impact on low income or other vulnerable groups.

On the revenue side the President's budget contained a $12.7 billion dollars in taxes over the next three years in addition to the contingency tax which totals up to around $70 to $80 to $90 billion dollars. The $12.7 was a health care cap which I support. I am not certain how many on this committee support it but in my view it is not bad.

In addition, Treasury supported a number of these areas, the public property leasing and nearly everything on this list. I am not certain how much revenue we are going to have but there are things that have been called to our attention through hearings on Senator Grassley's subcommittee and the full committee on other areas that we seek to address not with just simply revenue raising in mind but trying to make the system work, simplify it in some areas and deal with somebody's concern that have been expressed by industry not just tax raisers and try to resolve some of these problems.

As far as I know there is no move a foot to have a tax increase. No one is discussing, at least I am not, changing indexing. Some would on this committee. In my view that is the best thing we did in the 1981 tax act. No one is discussing changing the marginal rates. Some may think we went too far with the Roth-Kemp bill. We are paying the piper now for that folly. I don't suggest it is a folly. I am repeating what I have heard.

(Laughter.)

Senator Roth: You had my worried.

The Chairman: I voted for it. I cosponsored it. I have always called it Roth-Kemp rather than Kemp-Roth. If it continues to deteriorate I may want to switch that around. It just seems to me that our responsibility is to address the budget resolution. We may come up with no revenue. But I don't think that we can close our eyes to some of these areas that should be addressed.

Many are raised by committee members. I must add this. In addition to these things that might raise a little revenue I know of 40 or 50 amendments from committee members that would cost money. So if we are going to take the taxes, we shouldn't increase taxes. I hope we also adopt the rule that we are not going to lose any revenue with a lot of things that people want to present to the committee.

That might be the best of both worlds. At least you break even. I don't know what the Treasury view is. I read this morning that the deficit has been reduced in Don Regan's latest speech substantially based on some assumptions that he makes.

Senator Roth: I would like to hear from Treasury.

Mr. Pearlman: Mr. Chairman and Senator Roth, I am not going to comment on the deficit. Others are better able than I to do that but let me say that much of what the Chairman said is indeed the Administration's view. While we are not able to support revisions that are pure revenue raisers and we would not support provisions that are pure raisers that we do think that there are items that do need attention. A couple of those the Chairman has mentioned, public property leasing and life insurance, that need to be addressed. They are important and need to be addressed. We are fully supportive of addressing them.

There are other items that we have been advised are under consideration by the committee which we would view as not being revenue raisers but rather if you will protections against base erosion, items that are needed to make sure that current revenues, current receipts that are in the budget calculation are not eroded and we would be supportive and hope to work with the committee in trying to deal with those items.

I think we come out clearly. We are not in favor of a tax increase. That is the President's position. There has been no change in that position. We are interested in trying to make the kinds of improvements to the Internal Revenue Code that are not tax increases such as the ones the Chairman has indicated.

The Chairman. I want to introduce somebody in the audience who just walked in with his wife. I wanted to introduce his wife but he is here, too. Senator Curtis who was a great leader on this committee and raised a lot of taxes in his day and his wife, Mildred. We appreciate your being here.

(Applause.)

Senator Symms: This is pertinent to Senator Roth's line of questioning and to what the Treasury is saying here. I had a question with White House counsellor, Ed Meese, last night. In the process of this conversation about the potential that I was concerned about that I could see the ugly head of a tax increase rising again here in Washington, he told me that he was just interviewed by U. S. News and World Report and they asked him directly what is the Administration's attitude on a $12 billion dollar tax increase and he said, "It is very simple. It would be a $12 billion dollar veto." I don't think takes away from what the Chairman is talking about.

Senator Bradley: Ed Meese said that last night.

Senator Symms: He told me that last night that he was just quoted as saying that to U. S. News and World Report. I think that does not take away from what the Chairman is saying that there are some of these things that have to be done like this insurance company problem that has to be taken care of. I think it would be nice if we could settle the fringe benefit thing once and for all so people would quit having to worry about the IRS coming in and taxing their airline ticket or taxing their discounts that they get from the place they work.

I would like to settle some of those things. I think we need to recognize that if we try to move forward on anything that even looks like a tax increase, it is gone. It is not going to take place.

Senator Roth: Mr. Chairman, I had not finished. If I might just finish and then I will be happy to yield the floor. I recognize that there are some pure loopholes that ought to be closed. I am not opposed to that. I am very much concerned and I say this to the Treasury, I am very much concerned that what is a loophole can become the basis of a major tax increase.

I am just speaking for myself now. This is one senator who opposes any tax increase beyond trying to close a few loopholes.

Mr. Pearlman: Senator, I think that Treasury's views are consistent with yours in that regard.

Senator Bradley: Mr. Chairman.

The Chairman. Yes, Senator Bradley.

Senator Bradley: As I understand the Administration's position, Mr. Meese and the President who carries his veto pin by his pillow, I am told, will veto any tax increase. The Treasury Department is against any pure revenue raisers. But you have the term and there are a few inpure revenue raisers. Is it going to raise revenue or is it not going to raise revenue? If we raise revenue, is the President going to veto it or not? That is the question. The answer seems to be the President is going to veto it. So why are we meeting?

(Laughter.)

The Chairman: Everybody has to be somewhere. You might as well be here.

Mr. Pearlman: Mr. Chairman, I am not going to try to clarify what Mr. Meese says or try to suggest --

The Chairman: He is not the one who vetos it. He just works there.

Mr. Pearlman: He is somewhat closer to the veto than I am. Let me say that the Administration has said explicitly that it does support dealing with the subject of a taxation of life insurance companies this year and it has said specifically that it does support dealing with the subject of public property leasing.

I presume from that that Mr. Meese was not dealing with that kind of item but rather with pure revenue raisers.

Senator Bradley: What are they?

Mr. Pearlman: I presume that my statement is not inconsistent with his.

Senator Bradley: Life insurance and leasing. I understand that the Administration wants to do something about leasing but as we all know having been visited by a hundred people in the last three weeks, the question is not to do something about leasing or what.

Senator Roth: Why don't we cut spending?

Senator Bradley: It seems to me that if we did something about leasing and we did something about life insurance that would raise how much from what the Administration wants to do about leasing and life insurance?

Mr. Pearlman: We are projecting that the bill that has been reported out of the Ways and Means Committee in the life insurance area will not be a revenue raiser based on current revenues but indeed may even produce some revenue loss. I think that is what you were commenting on when you said you have to look at the revenues.

The life insurance bill is not being looked at as a revenue raiser.

Senator Bradley: So we won't raise any revenues from life insurance?

Mr. Pearlman: I can just tell you our projections at this point are that the life insurance bill will not raise revenue over current revenues.

Senator Bradley: So the Administration's position is that they support changes in life insurance but any changes in life insurance should not raise any revenues.

The Chairman: That is not the Administration's view.

Senator Bradley: That is what he just said.

The Chairman: He is just saying what the House bill does.

Senator Bradley: I asked him how much revenue increase will come from the life insurance proposal that the Administration is supporting?

Mr. Pearlman: At the end of this year, Senator, under the expiration of stop-gap, there is a very substantial increase already in effect in the life insurance industry. With no action by Congress that just goes into effect. The bill as reported out of the Ways and Means Committee will produce less revenue than the revenues that will begin to become taxable in 1984. We do not look at that as a revenue raiser.

Senator Bradley: So you support no change in other words?

Mr. Pearlman: We think that there needs to be some details addressed in the Stark-Moore bill but we are generally supportive of the Stark-Moore bill and we are not supporting it because it is raising revenues. That is not the objective. It is to try to get the taxation of life insurance companies on a more rational basis.

Senator Bradley: So we get no deficit reduction our of life insurance. How much deficit reduction do we get out of the leasing proposal that the Administration supports?

Mr. Pearlman: Our projection on the leasing bill through 1986, Senator, is $4.2 billion dollars.

Senator Bradley: Four point two through 1986.

Mr. Pearlman: Through 1986, correct. I can only tell you that that specific area, that is, tax exempt leasing is one if you will is an exception to our -- we do want to look at tax exempt leasing and we are supportive of the tax exempt leasing provisions. We think there is a big gap in the system now that needs to be dealt with.

Senator Bradley: So the Administration is prepared to go over the next three years, 1984, 1985 and 1986, to using revenues to reduce the projected deficit from $600 billion to $596 billion. Is that right?

Mr. Pearlman: Senator, our support of the leasing bill is not again because it raises revenues but we think there are some problems with the system and they need to be dealt with. Our motivation is to try to cure what are perceived to be some defects in the system.

Senator Bradley: But no other revenues?

Mr. Pearlman: It is not motivated by a desire to raise revenue. That is correct.

Senator Chafee. Mr. Chairman.

The Chairman. Yes. Senator Chafee.

Senator Chafee. Mr. Chairman, it seems to me as we go around the country that the most disturbing single factor that I encounter are the high deficits, the $200 billion dollars that are projected for this year, next year and the year after unless we do something.

The direct result of these high deficits is not only the fact that the interest rate is hovering so high and perhaps going higher but just as importantly the effect it has on the value on the dollar. Anybody who says the deficits don't affect the dollar and thus our imports, I don't think are paying attention to the situation that exists here.

So Mr. Chairman, the budget resolution provides that we raise $73 billion dollars in new taxes. Maybe we can't do that but certainly I hope we will make an earnest effort. As such I will move at the first opportunity to repeal indexing which was never part of the President's original program which somehow he got down a slippery slope and into and I think it has just been a disaster.

That will give us $23 billion dollars. We can get rid of something that the people don't have what they perceive as the beneficial effects of.

The Chairman: We can do away with tuition tax credits.

Senator Chafee: You can try that. We will have a vote. What is doing us in in this country is the deficit. Perhaps one way around it, you, Mr. Chairman, pointed out that you think getting $73 billion dollars according to the budget resolution is going to be extremely difficult. At the same time all that was asked of us for spending reductions with all the programs we have control over is something short of two billion.

That gives you $75 billion dollar reduction in your deficit over the period. Whether it is achieved by nex taxes or achieved by spending, maybe we can work out some kind of a compromise and it ends up with the same result when it nets out. I think that has some merit to it.

I certainly hope, Mr.Chairman, we will try as you mentioned

Tuesday at the luncheon that we will try and wrestle with these problems because the effects of the high dollar on exports is truly devastating to a whole series of industries. Of course, it ends up in costing Americans jobs.

So whereas we can all get off a lot of good speeches around here on how wicked new taxes are somehow we have to deal with these deficits.

The Chairman: Senator Armstrong.

Senator Armstrong: Mr. Chairman, I hope we won't prolong the discussion of indexing because in my opinion it really diverts attention from the underlying problem which is excessive spending. I don't intend to dwell on that today although at some early date I am going to circulate to members of the committee a discussion of that.

I don't see how anybody taking a fresh look at the fiscal mess this country is in can really conclude that we are under taxed. Despite everything, despite all the rhetoric about how we have cut taxes, in fact, taxes are on the rise in this country. They are not on the decline.

Average working families are paying more in taxes than they did in earlier generations, not less. Taxes are presently scheduled to go up, not down. Senator Chafee, I wish you would just think for a moment about some concrete instances of how real live taxpayers in Colorado or maybe in Rhode Island are affected by this. I am not talking about the wealthy. I am not talking about how income taxpayers. I am talking about taxpayers in the lowest levels of taxable income.

Of course, there are a lot of people in this country who are exempted from paying income tax because they simply don't have much in the way of income. Let me just take for example somebody who is making $15,000.00 last year, 1982. They will pay more taxes by 1984 than they did in 1980. That is even taking into account the full 25 percent tax cut the rate reductions that we gave assuming that we don't repeal those as some would have us do.

I am not talking about somebody whose income is a million dollars a year or a hundred thousand a year or fifty thousand dollars a year, I am talking about somebody whose income is $15,000.00 per year.

Let me also point something else out. If you start monkeying around with indexing, you will disproportionately affect the lowest income taxpayers. The indexing of the personal exemption affects the lowest income taxpayers 10.7 times as greatly as it does the highest income taxpayers.

If there is one provision in that tax cut we put through that really is to the benefit of middle and lower middle and low income taxpayers it is indexing. So if we are going to get serious abour raising taxes and I for one think it would be a horrible mistake to do so, but the last place we ought to go after is the indexing provision which is primarily for the benefit of low and middle income taxpayers.

I happen to think that Senator Symms and Senator Roth and the others who have spoken against the idea of raising taxes are right both on the grounds of macroeconomics and tax justice. I think it would be just about the dumbest thing we could do from an economic standpoint to put through another big tax increase.

If we have to do it, I beg of you please don't go after the little guys. Go after somebody else.

Senator Long: Mr. Chairman, I just want to make this point. We started out in this Administration with this wonderful idea. It sounded great. We heard so much about it that it deserved a try and that was supply side economics. All we have to do is to have a great big tax cut and it won't cost us anything. We will make a profit.

So we cut taxes $750 billion dollars and we are now $750 billion dollars deeper in debt because we cut the taxes by $750 billion. It is almost a dollar for dollar trade-off.

I have had my taxes cut along with everybody else. I enjoyed the tax cut. But the question is, can we afford all this? Obviously some of these tax cuts that you are talking about is just an adjustment for inflation. When the inflation went up, your taxes went up with it and your expenditures went up with it.

We are not necessarily any poorer just because we are paying some taxes. I am paying just a lot of taxes just to speak as one member of this committee -- a lot of taxes -- a lot to take care of quite a few poor people who need some help. We are not any poorer as a nation because people like me pay taxes that make it possible for these dear old people to get some medical care or to draw a little social security check or to provide for some mother and some children and then so far as the government taxes the money away from me to spread out among somebody who needed a great deal more than I do, I am glad to pay my part of it.

I am not that much overtaxed even though I am paying a lot of taxes. I just think that when we look at the fact that we are running a $200 billion dollar deficit, it means that at some point we are going to have to do the responsible thing. That is, we are going to have to pay more on the footin' up end and take less on the takin' down end so that we bring the two together.

I think at some point that those in the White House and the President on down are going to see it and those on this end. I voted for Bennett Johnston's balance of budget amendment over a three-year period. I voted for Jesse Helms' idea. Some of us have to start not only for some of these balance of budget proposals but for more than one of them so we can get a majority behind something that leads up to fiscal responsibility.

For us to keep saying oh no, we are going to get it all under control but we are not going to do it by raising any taxes when it is so far out of balance I don't think that we can find the heart to make all the cuts that are going to have to be made if you are going to do it all along the cutting side. You are going to have to work on both sides of it.

The Chairman: Senator Bentsen.

Senator Bentsen: Mr. Chairman, as often happens in these things we go to excess. There is no question but we had to cut taxes. We should have. There was no question that we had to increase defense expenditures and we did. The problem is trying to do them to the extent we did at the same time we had the tightest money policy in 20 years.

There is no way that this economy can digest that. It means that we have to have some moderation in each of these. We are still going to increase defense spending but we have to stretch it out some. On some of the excesses in tax cuts, we have to moderate them.

You cannot pile these $200 billion dollar deficits on top of each other without doubling this national debt within the next six years. That is an absolutely unreasonable and unconscionable burden to put on our future generations. Corrections have to be made.

Let me get a clarification on a different point here that was brought up earlier. Mr. Pearlman, I am trying to understand where we are insofar as the Stark-Moore bill. I had been told and this may be an error and I want you to clarify it if that is the case, I had been told that Treasury and the stocks and the mutuals and the Ways and Means Committee had hammered out a compromise that the Administration was supporting. Is that or is that not correct and if it is not correct then in what respects do you differ with it?

Mr. Pearlman: Senator Bentsen.

Senator Bentsen: If you can listen to two of us at the same time with that fellow talking in your ear, you do a better job than I do. Did you hear all my question?

Mr. Pearlman: I heard your question.

Senator Bentsen: Good.

Mr. Pearlman: I think I can answer your question. That is correct. With the exception of some minor technical aspects of that bill that still need to be resolved, there is an agreement. I think what you heard was an accurate statement.

Senator Bentsen: Let me ask you then, you made a point about revenue. You are supporting it all the way except for some minor technical aspects, is that what I understand from the Administration?

Mr. Pearlman: That is correct.

Senator Bentsen: Thank you.

Senator Matsunaga: Mr. Chairman, have we abandoned the first come-first ask policy of the committee or are we on a last come-first talk policy now?

The Chairman: I am sorry. I didn't see your hand.

Senator Matsunaga: I was trying earlier but that is all right. I had earlier questions relative to the Stark-Moore bill on insurance.

I think Mr. Chairman what we need to do is to have from the Administration the policy on which its decisions are based. What is the Administration's policy? Is it to encourage the purchase of life insurance by the populace? It is to discourage?

As a former insurance agent although purely on a part-time basis at which job incidentally I made more money than on a full-time federal job, I want to know what the policy of the Administration is with relation to all of these itemized things. I think that would determine which way we ought to go. If that policy is as I feel it should be in the area of life insurance to encourage the purchase of life insurance by tax breaks and otherwise so that we won't need to increase our welfare program so long as the individual citizen through his own earnings and through his own payment of premiums will provide for his future, heavens, what are we doing?

I say this as a cosponsor of the Symms proposal. I say what is the policy of the Administration? Do we wish to encourage the use of fringe benefits on the part of employers to retain employees on a permanent basis as some of the older companies in Hawaii used to do. The annual bonus, the people keep on working because they are going to get the bonus.

These are the policies that need to be determined before we act and before the Administration even makes its recommendations, I believe, Mr. Chairman. I would ask this question relative to the fringe benefits thing. Perhaps the Administration will agree to a permanent freeze on the activity on the part of the IRS snooping around looking for non-statutory fringe benefits which can be taxed.

Would the Treasury Department go with that freeze if we should order it?

The Chairman: Could I just say that we are here because we are trying to respond to the budget resolution. It may be that we may not agree with everything the Administration proposes and again I must say that if we cater to every special interest group that is here or in the hallway, we aren't going to do anything.

Obviously we can lose $100 billion dollars in revenue by taking care of everybody's amendment and doing nothing on the other side and I am not getting into fringe benefits or any other area but we are all out there making speeches about the deficit and now we have an opportunity to do something to do something about it. I don't want to prejudice what Treasury might say but I am not certain. It is certainly material and we want Treasury's view. We don't have any provision on fringe benefits. Some suggested extending the moratorium. Senator Symms has a bill. The House has passed a bill. We have it on our last because I assume we will be going to conference and we thought at least we ought to have expressions from committee members and the joint committee, our own staff and Treasury.

Senator Matsunaga: What disturbed me I am sure as it has other members as have been expressed here is that the Administration is waiting with a $12 billion dollar veto and a $12 billion dollar tax increase as the senator from Louisiana and the senator from New Jersey have said, what are we doing here then? Heavens. We are trying to balance the budget somehow and one way is to increase the revenues. One way to increase revenues is to increase taxes.

When I first ran for office, Mr. Chairman, some of us feel that maybe a proposal to increase taxes will spell defeat. When the Democratic Party first took over the government of Hawaii, the territory of Hawaii, it ran on a platform of balancing the budget and increasing taxes to balance the budget. This is in 1954. The Democratic Party took over the territory of Hawaii for the first time in 54 years on a policy of increasing taxes.

I would think that we should do the right thing. I think the American people will understand. That is what we ought to do.

The Chairman: I hope we do the right thing. I get all kinds of signals that the right thing is spending more money and that we don't intend to do. We are not going to load a bill up with a lot of revenue losers. That is not my intent at all. Whatever the Administration's policy may be, I think we all recognize we have a problem in the deficit and we can all say that it is because of this and that but the fact is still that we have a problem.

Senator Matsunaga: I am still waiting for the answer.

Mr. Pearlman: Let me try, Senator. The overall policy of the Administration has been and continues to be that we are not supportive of revenue measures as revenue measures. There are some specific items that the committee has invited us to comment on through testimony and that are before you which we do not believe are revenue raisers and the Administration has specifically indicated its support for those items the most notable being the taxation of life insurance companies and the area of tax exempt leasing.

Beyond that we are here to try to respond and to provide assistance to the committee and obviously to try to deal with areas where we think there may be potential for erosion of the current tax base.

I hope that is responsive.

Senator Baucus: Mr. Chairman.

The Chairman: Senator Baucus.

Senator Baucus: Mr. Chairman, frankly I think we all know what is going on here. This committee knows. I think the

Administration knows. The House knows. People know that we have a deficit that is too high. We have to live within our means. The only way we are going to address it as we should address it is some combination of spending cuts and some revenue increase, some combination -- both because it is right and also because it is the only politically acceptable approach.

Frankly this never-never land that we are in right now this Alice in Wonderland atmosphere that we are in right now while we are fiddling while Rome is burning, I think is going to begin to outrage the country, the people very significantly. Everyone is like Alphonse and Gaston. The President is waiting for Congress. The Congress is waiting for the President. Everybody is waiting for everybody else to move.

It seems to me that Senator Boren and Senator Danforth with their proposal attempted symmetrical balanced approach to get at this problem is the first concrete approach to solve this problem.

I think that when we convene next session whether it is this afternoon or after the recess that we have a responsibility to take that first step. We don't know the specifics yet but generally follow the approach of Senator Boren, Senator Danforth and Senator Wallop to find some way to take that first step because I have a hunch, strongly feel in fact that we are therefore be filling that void and that vacuum that everybody is waiting for. Everybody is waiting for somebody else to move.

I understand the point that the Senator from Rhode Island made about indexing. I am opposed to repealing indexing for the same reasons that Senator Armstrong mentioned. I also think that we are also going to have to cut some spending as well as raising some revenue if we are going to solve this problem.

I think we all know that is what is right. I think the President knows that is right. I think that we are incorrect if we and the White House think that politically it is best to hope that all this takes care of itself until after the election. A lot can happen. That election is 13 months away. It is going to boil over. We had better pay our debts earlier rather than later.

I strongly encourage us to do what we know we should be doing.

Senator Armstrong: I just wanted to ask a question. I wanted to be sure I understood what Senator Baucus was saying. Did I understand you to say that you endorse the Boren-Danforth proposal but not to the extent that it bears on indexing?

Senator Baucus: I endorse the concept. I endorse the idea I endorse the approach to try to find some symmetrical solution which cuts spending generally in the same proportion as it raises revenue. I specifically would prefer to raise revenue in some way other than repealing partially indexing that we enacted at an earlier time. I don't like that approach. I would rather raise revenues some other way. I like the approach of generally finding a symmetrical balance evenhanded, attempt to find an evenhanded fair approach to both raised revenue and cuts in spending.

The Chairman: I want to thank the Senator from Montana. In my view you are exactly right. The two big players in this town haven't suited up yet and that is Tip O'Neill and Ronald Reagan. Until they suit up, it is gamesmanship. Maybe this committee can provide some leadership. We hope that we can continue on a bipartisan basis to put together a package that will reflect our determination to reduce the deficit.

It may be more taxes than Senator Roth would like to accept. It may be more spending cuts than somebody else would like to accept. I don't know what choice we have unless we just want to keep on making speeches and let the economy go down the drain in the process. I think if there are enough of us on the committee, I think everybody shares the view that it is a problem. If there are as many votes for the specifics as there are for the general problem, we will make it all right.

Senator Boren: Mr. Chairman, I certainly agree with what you said. I met with a group of business leaders yesterday who said why can't we have some leadership. Who is going to solve this problem? There is not one person in the United States unless it is perhaps the Secretary of the Treasury that thinks that these deficits don't matter and that we are not going to go over the edge of the cliff in terms of either high interest rates or having to get some new printing presses. We are going to be called on to do that if we don't get them down to print the money faster than anything we have now if we don't let the interest rates rise up.

I just think we have to do something. It is disconcerting to hear people try to not admit what has to be done and say that we are going to have some spending. We are going to have to raise some revenue.

When the Treasury Department of the United States will not come in and admit that openly, it is sure disconcerting to any of us who want to take the political risk necessary to solve the problem. It is a terrible absence of statesmenship and responsibility on their part. I am very disappointed to see it and I hope, Mr. Chairman, that you will continue to try to follow the responsible role that you are trying to follow and that our committee will do so.

Senator Armstrong: Mr. Chairman, I am not trying to have the last word unless I can. I really cannot think of a single member of the Senate for whom I have a greater admiration than I do the Senator from Oklahoma particularly on this issue.

He has sounded the alarm over and over again. I think he is right that probably Don Regan is the only guy in the country that doesn't think these deficits are a terrible problem.

I believe that Senator Boren was probably one of the very first senators to call attention to that problem long before it was fashionable to do so. But David I must urge you to take a look at the real trends of taxes and spending. Those deficits do not -- I cannot see how anybody can look at those and say that the deficits arise because we are under taxed.

What we have is an explosion on the spending side. That is where the savings have to be made. You can't raise taxes enough to close that gap. The symmetry of the proposal you advance and it is not an unreasonable proposal. I don't say that it is. It would have been right on target if somebody had advocated it in 1970.

What we have seen in the last ten or 12 years is a doubling and tripling and quadrupling on the spending side and no relief at all on the tax side. In fact, taxes despite what Senator Bentsen has said and despite what Senator Long has said and others have hinted out, taxes are rising. They are not going down.

So any notion that there is a justice or a symmetry in raising taxes and cutting spending, I just think flies in the face of the facts.

Senator Boren: Mr. Chairman, I won't get into a debate with my good friend. I appreciate his kind comments. I just think that we have a gap. The spending is going up. There is no doubt about that. We had spending at about 22 percent of the

GNP three years ago. It is at 25.5 almost 26 percent of the GNP now. Federal revenues, however, have declined slightly, federal revenues from 20 percent of the GNP down to about 18 percent. The point is that the gap is now 7.5 percent instead of 2.5 percent. It is getting wider. I would prefer to see us do more on the spending side.

The good senator from Colorado has convinced me to be in favor of indexing on the tax side. I would not favor the repeal of indexing. I think perhaps a temporary partial contraint on it might in fact be the way that it is saved rather than harmed. I would urge him to think about that.

Senator Armstrong: I didn't think that I could get the last word.

Senator Roth: If I could just point out what the figures are that you referred to, Senator Armstrong. Outlays for 1983 to 1988 would be 24.8 percent of GNP. That is the highest in the history of this country. In 1982 it was 24.6 percent. In 1981 it was 23.6 percent. In 1980, 23 percent.

Now on the receipt side revenue is about as high as it has ever been except for the year 1981. You were exactly right. There have been no major tax cuts. Revenue during the 1983-1988 period will be 19.7 percent. The highest it ever was in 1981 was 20.9.

So all the people who are saying that there have been major tax cuts, the fact is that they are offset. They are offset by other revenue measures so whether you call it supply side or whatever it is, there has been no real test of it. The real fact of the matter is that we are taking more and more out of the private side and not giving the recovery a chance to show what it can do.

If you really want to do something about deficits, we had better get some real growth in the economy. That is the way you are going to reduce the deficit. All this talk here that we are going to raise revenue and we are going to do something on spending, I would just point out again that on the House side this year that they have proposed a $24 billion dollar spending increase.

I would just point out that the Senate yesterday overwhelmingly increased spending by four billion dollars. So I hear all this talk about reducing spending and all the other things but I don't see any indication that that will be done.

The thing that history shows us is that if you raise revenue, you are just going to encourage those who believe in big spending that we ought to increase the spending side.

I would go back to what I said earlier, Mr. Chairman, I think there are some loopholes that we probably can close, but I think we ought to listen to the business community and most of the organizations from small business to big business would like some certainty.

We have had so many tax changes in the last two or three years it is no wonder that no one wants to invest because they don't know what we are going to do next. I will be interested in seeing when these spending cuts take place and then maybe we can talk about it.

The Chairman: I think we might be on the right track. I put together a little paper. If we had eliminated all the things we put in the tax bill the President didn't want and didn't ask for in the tax bill in 1981, we would pick up $79.5 billion dollars in 1984, 1985 and 1986. If we had enacted all the things the President wanted and didn't get, it would be another $23.4 billion dollars. There is $105 billion dollars in revenue of things the President didn't want that we gave him and things that he wanted we didn't give him.

There are all kinds of things we can do. I wouldn't recommend changing some of these. But if we really put our minds to it I think there is an indication in this committee including Senator Roth and everybody else if we can get the right package not raising revenues in the sense of going back and undoing anything and I would oppose changing indexing. I also live in the real world. I think we ought to continue to work on that and will be doing that as we go through.

I would like to go through the rest of this list.

Senator Bradley: Mr. Chairman, may I say one thing? The point is the President signed the tax bill in 1981.

The Chairman: Right.

Senator Bradley: That guaranteed the revenue hemorrage and while everyone has great ideas and everyone has properly ideas to deal with this, we are only nibbling around the edges because we are unwilling to do what you pointed out which was to go back to the 1981 Act and make some serious changes.

Even the proposal that Senators Boren and Danforth offer is about $30 billion a year. So we still have $170 billion deficit. If we are serious about addressing the problem and you don't want to go back to the 1981 Act in any way significantly, you have to have a lot more cards in the deck to put in here than simply what the Finance Committee is going to do and that implies a much broader forum in which you could actually trade.

That is why I think the suggestion that you have made from time to time which is getting a bipartisan conference so that you can actually address the $200 billion dollar budget deficit is not a real bad idea. I think it is a good idea because that is the only way absent going back to the 1981 Act that you are going to be able to make the trade-offs that you have to make.

As any number of people have said here today, the deficits are quickly translated from an economic problem into a political problem and into a strategic problem.

You can find countries around this world in the next six months to a year declaring a moratorium on their debt because they can't afford the interest rate and suddenly we have a much different world.

The Chairman: Senator Bentsen.

Senator Bentsen: Mr. Chairman, I just want to speak to a specific on the agenda. You and Senator Moynihan showed a great deal of leadership on the tax bill when we got into the problem of commodity straddles.

It is my understanding and I have been advised that there is still some ambiguities and some question involved in that and an amendment has been proposed to try to bring about some clarification.

It is a very technical subject and I would hope that you and Senator Moynihan and your staffs would take a look at it and see if this is a proper approach to try to settle some of the questions.

You set up a transitional rule there that legitimatized and understood that you had legitimate straddle in instances where they were entered into with the anticipation or hope of profit. If the staffs could look at that, I would appreciate it and see what you and Senator Moynihan think on it.

The Chairman: I mentioned in a discussion with Republican members the other day that we had had a number of inquiries. In fact I think Andre has been aware of those and others have where there are some who feel that while they may not have agreed that we fairly dealt with the issue at all in 1981 what they are concerned about now is the fact that IRS and other procedures being used in the years prior to that, is that correct? That is the concern that has been expressed?

Mr. LeDuc: Yes, Mr. Chairman. That is one of the concerns.

The Chairman: If there is a tax, whether the rate is going to be 32 percent or a higher rate, is that also the case? That is another issue?

Mr. DeLuc: Yes, sir.

The Chairman: I appreciate your raising that. We were also told at the time we addressed it that stock option straddles, I guess, would be too expensive or something. They wouldn't be an issue. We understand now. You might just address that briefly while we have it up because we are going to look at the others, Senator Bentsen.

Mr. LeDuc: In 1981 stock option straddles were carved out of the general rule enacted for commodity straddles based on our understanding and the Treasury's understanding at that time that the potential problems were not present with respect to stock options.

I think at the staff level there is a judgment that based upon a number of tax shelter prospectuses that have been shared with the staff that there is a serious problem here. I think the industry agrees that there are some problems. There are a couple of options that would be available to deal with this problem.

The first described in the materials circulated to the committee would take stock options and move them into the general rule for commodities which are the loss offset rules. An alternative approach that perhaps ought to be explored would be to move stock options into the market-to-market rules.

The Chairman: Has the joint committee looked at that also, Jim?

Mr. Wetzler: What has happened is that in the last couple of weeks the industry has made a legislative proposal. We have met with them. It is a complicated area but I think the proposal is a promising one that looks like it could deal with the abuses that Treasury referred to in its testimony earlier in the year and also solve some of the industry's problems it is having because of the differences in tax treatment between futures contracts and options.

So we are working on that. It is a fairly complicated area. We are working with Andre and the Finance staff to see if we can work something out.

Senator Symms: Has the proposal that Senator Bentsen and Senator Moynihan have made been looked at? Is this to try to go back and address the problem?

Mr. Wetzler: There are two separate issues. Senator Bentsen, I think, is concerned with the transitional issue --

Senator Symms: Right. That is what I am concerned with too.

Mr. Wetzler: -- regarding what was done back in 1981. We are looking at that and then the stock options question is something different. That is looking towards the future.

Senator Symms: I would just say, Mr. Chairman, that if we could do something on this I think we really ought to direct the IRS because the transition rule has been the problem on the market-to-market. I am not going to get into a philosophical discussion of market-to-market here because I do think that history will prove that it weakens the forward months. That is neither here nor there.

The Internal Revenue Service, I think, needs Congressional direction of what they are doing on going back and disallowing what were up until -- actually what trades that had been accepted as the way to do business since about 1938 or so and they have just changed it all of a sudden without the consent of Congress.

If they have a proposal, I sure would be interested in having us give some clear direction from the Congress to the IRS.

The Chairman: I am glad it was raised by Senator Bentsen. Senator Moynihan did mention it to me earlier this morning. I did raise it in a meeting with Republicans the other day. As far as I know there isn't any proposal. What I would suggest is that the staff and the joint committee take a look at what may be proposed or at least some options as you look at the stock option straddles and foreign corporation commodity straddles, I think that is an area we had better move in on quickly before we have another gaping problem.

We will address the concerns expressed.

Senator Moynihan: Could I thank you for that statement, Mr. Chairman? I think clearly the foreign option arrangement has to be stopped before it really gets going as we did with commodity straddles.

In the straddle legislation we provided for a five-year transition for persons. We certainly had no understanding and made no statement, we explicitly made no statement about legality or illegality. If there is a question of IRS mistreatment here, I think we would like to hear from the staff about it.

The Chairman: I am not going to get into that now. It has been raised and we will take a look at it.

Senator Bradley: Mr. Chairman, could I make a request that on the document that has the agenda with all of the other revenue options where we have the law, background and explanation could we also have the revenue figure? I don't see that.

The Chairman. Yes. That would be helpful.

Mr. DeArment: Mr. Chairman, the joint committee was still working on some of the revenue numbers. That is why they were not included, I think we will have those available shortly.

Mr. Wetzler; We don't have revenue figures for every single one of them but we will pass around what we have.

The Chairman: I am not sure we are going to be in session but if we are in session tomorrow, can we meet tomorrow?

Mr. DeArment: I don't think we have any conflict. Yes, we can meet tomorrow if the Senate is in session.

The Chairman: I think we might at least touch on a couple more of these. What is postponement of the effective date of the 15 percent net interest exclusion? That is an amendment offered by Senator Schmidt of New Mexico? What would that do, delay that or postpone it?

Mr. DeArment: Yes. We would delay it for two years. Under current law it would come into effect in 1985 and the proposal that is listed here would be to delay that effective date for two years. The 15 percent exclusion was one of the several savings incentives that we included in the Economic Recovery Tax Act in 1981.

Senator Symms: What is the revenue on that?

Mr. DeArment: The revenue right now over three years the revenue pick-up would be about $3.9 billion dollars.

Senator Symms: What is the projected loss as far as lack of savings? Does anybody have any numbers on that?

Mr. DeArment: Jim, would you like to answer that?

Mr. Wetzler: Since it hasn't taken effect yet, we really don't have any experience with it.

Senator Symms: But you anticipate though that would be an encouragement for people to save?

Mr. DeArment: That's correct.

Mr. Wetzler: Our concern, I guess Senator Symms, is that there has been a big cost overrun in the IRA program with the revenue loss from that coming in at about three or four times what was originally forecast. So we sort of already spent the money that is going to spent and the net interest exclusion on IRA's.

The Chairman: Plus Senator Grassley has another amendment that I think will add to that loss if it is passed.

Mr. DeArment: There has been concern that the amount of the 15 percent exemption really is so small that it may not have that much of an effect.

Senator Symms: What about raising it to 25 or 50, Mr. Chairman?

Mr. DeArment: The original proposal was for 25 percent. There is the same concern as we had with the one hundred dollar small saver that it is really not much of an incentive.

Senator Symms: I think that would be a mistake to include that in the bill, Mr. Chairman.

The Chairman: It may be. We haven't done it.

Senator Symms: I just want to be on record to say that I will oppose that one.

The Chairman: That is one of those that if we are trying to find any painless areas, that is one of the less painful. What about property and casualty insurance company? That is on the schedule because we did have hearings earlier. We had GAO witnesses and I understand their report that they testified about generally is available in rough draft this week.

Mr. Belas: Mr. Chairman, the property and casualty industry is comprised of approximately 3,000 companies. Those 3,000 companies over the last ten years GAO has determined have paid about three billion dollars in taxes, 3,000 companies.

Over the last five years just seven of those 3,000 companies paid over 52 percent of the taxes paid by the industry and one company paid about 25 percent of the taxes for the whole industry despite the fact that there are 3,000 companies in the industry.

The primary reason that these companies have not been paying much tax on their economic income is that they invest very heavily in tax exempt securities. Tax exempt securities now comprise about 40 percent of the so-called admitted assets of these companies.

The proposals that are in the staff document do not and are not intended to limit tax exempt income on the part of the industry nor are they intended to substantially change the taxable income of the companies.

The primary provision is simply to conform the accounting of reserve liabilities, the deduction for the reserve liabilities to the treatment of life insurance companies.

Basically a property and casualty company will determine once they believe an accident has occurred that they will take a deduction for the amount of the claim they expect they will have to pay even though they may not have to pay that claim for several years in the future and will earn investment income on those premiums.

The proposal would simply discount using an after tax discount rate which is intended to take into account the fact that the investment income will be subject to tax the amount of deduction for those reserves that can be taken in the first year.

Essentially what we are saying is that the companies can accelerate their deduction well before they have to actually pay out the claim. There is no question about that. It is just a calculation of how much of a deduction they get to take in that early year for a claim that will not have to be paid until far in the future.

The proposal would exempt out the type of business that is in fact settled over a short term period. For example, the primary examples would be automobiles, property damage, homeowner's property damage, fire damage and the like. Those are traditionally settled. The claims are settled within three years and there would be no reason to discount those.

Senator Symms: Could I ask a question on that? Isn't there a risk here that what you are really doing is lowering the reserves of the insurance company to be able to pay out claims. In other words we are going to put ourselves, Treasury, government as saying we know how much they are really going to pay out and they are taking a bigger claim than they are and then they are putting more reserves in. Didn't GEICO if my memory serves me correctly go through a process where they had a problem of having more policies written and more claims than they had reserves and then some changes were made to expand the reserves? Isn't that really what we are talking about?

Mr. Belas: Senator Symms, the nature of the business is a guess or an estimation of what that liability will be within the policy limits of course and when that claim will have to be paid.

Whether you discount reserves or not that risk or that guess on the part of the company is a business risk that they taken.

Senator Symms: Then what we would be doing is passing this off to the people who have to pay for automobile insurance or casualty insurance?

Mr. Belas: Yes. You might think of it as that. The federal government is in the business of partially insuring or partially paying for the premiums of a person who buys automobile insurance and the question is do you do that.

Senator Symms: No. You see my point is I think that this is a lot more serious than meets the eye. I think if we start tampering with that you may find out you have a whole bunch of property and casualty companies out here that end up with more claims than they have the ability to pay for them. The only answer then would be that you have to raise all insurance rates. That clearly would be a tax increase on consumers.

Mr. Belas: Senator, I think you must keep in mind that what is occurring if you discount reserves is not an increase in taxes. It is a timing question when the deduction will be taken and when the income will be taxed. The same amount of tax will occur. It is just a question of when that tax will be paid.

Senator Bentsen: Mr. Chairman.

The Chairman. Senator Bentsen.

Senator Bentsen: It can't be stated just that lightly because the point at which taxes are paid makes a great deal of difference insofar as to the value of funds. What has been proposed is certainly a very interesting intellectual exercise and would go far beyond just the question of discounting the amount of reserves if you want to carry it to the fullest extent of the logic of that approach.

I don't quarrel with it. Perhaps something should be done in that regard but you are talking about a major change in the tax structure for that particular industry. I think that is one that ought to be explored. We ought to fully understand how far that goes and what its complete results would be. I think we ought to have the hearings specifically on that to try to understand it better.

The other point that was made about the industry paying a much lower tax in recent years, I have been advised that the industry is awash in red ink, that your loss ratios have been up around 112 percent and that had had a very material effect on what has happened on taxes in recent years.

Mr. Belas: Senator, they are obviously --

Senator Bentsen: Is that a legitimate statement that has been made to me?

Mr. Belas: Without question they are in a down cycle in the industry. There still is a question however whether they are economically not making money or whether they just are not making money on book according to the insurance departments or according to their tax returns.

Senator Moynihan: Just out of curiosity could I ask Senator Bentsen, I don't know if I quite followed what you said. I am just interested in the "awash in red ink" reference.

Senator Bentsen: It is my understanding and he has just backed it up that the industry is a serious down cycle business-wise and that their loss ratios are askewed and that they have lost a very substantial amount of money and their stock ratios are reflecting that.

If you really want someone who is sophisticated who will tell you that then go look at the stock market and see what has happened to some of their price earnings ratios and the investing community thinks they have problems and that they are serious problems.

What he is talking about as I see it is a major change in the tax approach maybe justified but I think it is one that we shouldn't do casually, that we should fully understand it.

Mr. Belas: Senator, the GAO has been studying this.

Senator Bentsen: That's right. But we don't have that yet.

Mr. Belas: We have from the GAO today a memorandum which states categorically that the conclusions that they testified to in the June hearing remain unchanged and the data on which it is based remain unchanged.

The appropriateness of discounting reserves is unquestioned in their mind. The report is not ready only because it is going through the bureaucratic changing of the commas question not that the conclusions are in doubt.

Senator Bentsen: I think it is very important that we have an opportunity, the rest of us, to look at that study.

The Chairman: Again it is on the agenda because we had had a hearing and it may be that we need additional hearings. Obviously those in the business are going to disagree when you start changing anything that may be helpful or beneficial.

I wonder if we might at least touch on some of these other areas so that we can avoid coming back this afternoon. Number

"E" is modification of income averaging. That is on the agenda because we passed out of this committee health care for the unemployed and we have agreed in the committee that at least those who voted for that package that we would pay for -- we are not going to pass another program unless it is paid for.

What we had done at the committee level was to reduce spending enough to pay for it over a two or three year period. The Administration is opposed to that. They feel that belongs in the spending reduction package but they would not oppose an appropriate revenue change.

This may not be appropriate but it has been suggested that the income averaging change on the agenda might just satisfy the amount needed to fund health care for the unemployed. Jim, do you want to comment on that?

Mr. Wetzler: One of the problems this addresses is that there is something of a double dip really between income averaging and indexing. When you index the tax brackets for inflation then if all that is happening to you is that your income is going up with inflation, your tax rate won't change and there is really no particular reason for you to have any income averaging.

The way the present system works you will still be getting benefits from income averaging. So really the idea here is that because we have enacted indexing, some sort of modest cutback in income averaging would be appropriate to eliminate this double benefit.

The Chairman: You don't eliminate it. You just modify it.

Mr. Wetzler: What is proposed here are two cutbacks that would approximately offset the double benefit that is perceived by combining both indexing and income averaging. An exact adjustment to eliminate the double dip would be kind of complicated so what we have worked out is two sort of approximate adjustments, two alternative adjustments.

The way income averaging works is that you compute your income over the four prior years. That is your base period. Then you multiply that by 120 percent and get a threshold and your income in excess of 120 percent of your base is your so-called averageable income. Then your income averaging basically is designed to reduce the marginal tax rate on that averageable income, the income in excess of 120 percent of your base.

The first proposal here just raises that threshold from 120 percent to 140 percent. The second proposal does two things. It raises the threshold to 130 percent instead of 140 percent but then shortens the base from four years down to two years. The theory here is that it is a fairly complicated provision for taxpayers to have to keep their tax returns for the prior four years. As a result of that many people who are eligible for income averaging don't elect it. By shortening the base period from four years to two years you would make the provision simpler. It would make it easier for the IRS to administer because the IRS has trouble tracking people's incomes three and four years back.

You would also cut down some of the benefits because averaging over a three-year period is less beneficial than averaging over a five-year period and that is where you get the revenue gain.

Those are the alternatives here under income averaging.

The Chairman: It may not be related but if we could drop from there to the last item on the agenda, the six month capital gains holding period. The primary objection to changing that from 12 months to six months has been the cost.

We believe that we have found a way to diffuse that argument without any impact on the desire to change it. It would lower it to six months. Could you explain that?

Mr. Wetzler: What we have down here is two things, one is to shorten the holding period from one year to six months effective for assets purchased after November 1, 1983. That is a somewhat different effective date than we have had in the past which would have the effect of making it clear that no one is going to get a benefit on gains that have accrued already.

It is only assets you have purchased in the future and of course you don't know whether you are going to get a gain or a loss on those future assets.

The second part of it and there is a misprint here on the effective date but the second part of it would today you can deduct capital losses against ordinary income up to $3,000.00. That was increased from $1,000.00 back in 1976 which was the same time that the holding period was lengthened to a year. This proposal would shorten the -- it would reduce the limit on the deduction of capital losses against ordinary income from $3,000.00 back down to $1,000.00 which is where it was before 1976.

The misprint is it should say for calendar year 1984 and subsequent years because you have changed the effective date on the six month holding period to make it prospective.

The Chairman: Would that respond to the argument that particularly House members have made that the problem with the six month holding period is the cost?

Mr. Wetzler: The change on capital losses would more than pay for the shortening of the holding period.

Senator Moynihan: Mr. Chairman, I know there is that concern but I think we have had experience in this committee of reducing rates and finding that far from costing the Treasury, the revenue actually increased. It wasn't dramatic perhaps but there wasn't a loss. In 1978 I think that happened. I would be interested in Mr. Wetzler's view or any of these gentlemen, in the theory of taxation it seems to me that to distinguish between capital gains and income is to influence economic decision-making because of a tax code. Now in the commodity exchanges we have abolished any capital gains period and it appears to be working fine.

I look to you, Jim, as our philosopher in these matters.

Mr. Wetzler: It is clear that any holding period distinction is somewhat arbitrary including the one-year holding period that is now in the law. I think if you just abolish the holding period entirely for stock without going to a market-to-market type of system the way you have done for commidity futures and the way the options industry is proposing that you do for options, without doing that if you just abolish the holding period I think you might have some trouble with various manipulative tax devices.

I would be hesitant to recommend abolishing the holding period before we have a really careful chance to study the possibilities.

Senator Moynihan: But you would be in favor of returning it to six months?

Mr. Wetzler: I don't really have a strong feeling about it. I think the holding period is pretty arbitrary whether it be six months or one year. The argument that the securities industry makes for the six months is that when you only have to hold the stock for six months to get a long term capital gain your chances of getting a gain will be, you will perceive them as being greater. Therefore, individuals will be more willing to invest in stocks. That will improve therefore the equity market and make it easier for firms to raise equity capital. They are in a better position than I am to evaluate how their customers will respond to an incentive like that.

Senator Moynihan: The shorter period -- the experience of stocks is to go up and down and the longer that period goes on the more likely you are to be on a down side and you can pick your up side in the shorter side. I guess that is the basic argument.

It seems to me that this distinction was put in a tax code in the 1920's, wasn't it?

Mr. Wetzler: I think in 1921 is when the Congress first enacted a special provision for capital gains. Since then there has always been some distinction between long and short term. It has fluctuated anywhere from six months up to about a year a half or two years and it was six months between, I think, 1942 and 1976 and it has been a year since then.

So we have experimented with every different way to do it.

Senator Moynihan: I don't want to detain the Chairman who has been very patient but it troubles me. It is like the concept of unearned income. A good economy would like to have people save as much and defer expenditure and so forth and having done what you want them to do, do you then declare their income to be unearned? Capital gains are income. It is only the Vanderbilts who get them.

The Chairman: We passed this in the Senate I think two or three times last time by a vote of 17 to 17 but this in my view has substantial resistance in the House. The reason I had heard was the cost. This would sort of take it back where it was. Is that correct?

Mr. Wetzler: These two provisions were adopted at the same time back in 1976. The holding period was really adopted originally as a way of paying for the increase in the loss offset. This would basically reverse what was done back in 1976 and keep the two linked together.

The Chairman: ~~This might satisfy Senator Bumpers~~ who I know is quite concerned about it and I think also Senator Metzenbaum.

Can we go to the expansion of the sport fishing equipment excise tax? This is a bill that I think Senator Wallop and other senators on both sides have an interest in. Harry, what is the deal on this?

Senator Symms: Before you go away from that, Mr. Chairman, I just want to say one thing while Senator Moynihan is still here and for the benefit of the staff from Treasury. I still believe that if you shorten the holding period that the historical record is there to show you that there will be actually more commerce and more business and more acceleration and velocity of the commercial activity. Treasury is going to get more money not less money by shortening the holding period. If you can work this out with the opposition to it, I think we ought to try to do it.

The Chairman: We are going to try. It is going to go in our package that we hope everybody votes for.

Harry, what is the deal on the fishing? Is it pretty good?

Mr. Graham: Apparently Mr. Chairman present law has a 10 percent manufacturer's excise tax on certain sport fishing items. H.R. 2163 as passed by the House would expand the number of sport fishing items that are subject to this 10 percent excise tax. Those funds are used to fund two separate trust funds which go back to the states and are used for facilities.

The Chairman: We are not talking about revenue gain. We are talking about money that is used for whatever it is used for.

Mr. Graham: Yes, sir. Each fund has contract authority so there is no offset as far as the revenue picture is concerned.

The Chairman: I had someone approach me yesterday and I should remember the name but who was concerned and he is a domestic manufacturer of fishing rods. I think he had been in to see you and he was looking for some amendment that would not prejudice a domestic manufacturer.

Mr. Graham: Concern has been expressed by domestic manufacturers that foreign importers can not do an arms length transaction and therefore avoid paying the 10 percent excise tax on the inclusion of their profit in the price of the item.

Consideration is being given to several different options one of which would move the collection point to the last sale before retail sale in order to alleviate that problem.

The Chairman: That is a real problem then that has been raised?

Mr. Graham: Yes, sir, to some extent.

Mr. Wetzler: I think, Mr. Chairman, the Ways and Means report has an instruction to the IRS to enforce more closely the constructive sales price provision to make sure that all parties importers and domestic manufacturers are --

The Chairman: I guess I should have asked. Is this in the Ways and Means? Are they considering this same provision?

Mr. Wetzler: This has already passed the House, I believe.

Mr. Graham: It has passed the House. The Ways and Means briefly considered moving the collection point but really did not have time to address it.

The Chairman: Does Treasury have any comment on this bill?

Mr. Pearlman: Mr. Chairman, on this particular point this point has been made to us as well that there may be a discrimination between domestic and foreign producers. That is of concern to us. We think we need to address that question.

The Chairman: I know even the vice-president is very interested in this measure. I have had all kinds of indications that this is very important. I don't fish so I don't know.

Mr. Pearlman: Our position and we have testified before the committee on the bill is that we oppose the diversion of the excess motorboat gasoline and motor fuel excise taxes into a separate fund but that we support the other two increases in Dingell-Johnston.

The Chairman: Does this raise additional money then, Harry?

Mr. Graham: Yes, sir. It raises about $100 million over a three-year period.

The Chairman: Where does that go?

Mr. Graham: It goes into the sport boating safety fund and also into the land water reservation fund.

The Chairman: Is there any objection? Does the Administration oppose the proposal?

Mr. Pearlman: We do oppose the diversion of the funds-- of the gasoline and motor fuel taxes into the fund because it has an adverse revenue impact. Otherwise, we are supportive of the bill.

Let me just note that we are somewhat concerned about the alternative that has been suggested of moving the tax to for example a wholesale level tax because of some of the collection to try to deal with the foreign problems.

The Chairman: Could we try to work out some of these problems?

Mr. Pearlman: Yes. I think we need to work on this.

The Chairman: As I understand this is probably not that controversial but we want to raise it publically so that everyone will know that it is all on the table and if anybody has any questions representing any domestic or foreign manufacturer, they will know that we have raised it.

I would hope that between now and the time we come back after the recess that we will have resolved as many of the problems as we can.

Mr. Graham: There are several proposals, Mr. Chairman, being discussed in order to resolve that problem.

The Chairman: What about number "J"? That is one that has passed the Senate several times and is always knocked out by Congressman Gibbons on the House side, withholding on gains from foreign investment in U. S. real property. That is another measure that Senator Wallop introduced and the only problem is it lacks teeth. It makes it difficult to get the tax. Is that correct?

Mr. Belas: The problem, Senator, you hit correctly is that the tax is imposed and there is no way to assure collection because the taxpayers are foreigners. The legislation as it is currently structured only requires reporting. Regulations have not been finalized to require that reporting. Therefore, the reporting is not even being done. There is a lot of criticism in the tax community on the nature of the reporting rules and it has been suggested by many members on the Senate side that an easier, a more effective approach would be to require withholding rather than reporting.

The Chairman: Does Treasury have any objection to that?

Mr. Pearlman: No. We are very supportive of this provision.

The Chairman: Why is it that it keeps getting knocked out?

Mr. Pearlman: I can't answer that. I don't know.

The Chairman: It has been in a couple of bills that we have passed, hasn't it?

Mr. DeArment: Mr. Chairman, we have passed this three times. We passed it in the 1980 reconciliation bill when we first passed the substantive provisions. We passed it in 1981 and in 1982.

The Chairman: Many foreigners are not to pay the tax sale. That is about what it amounts to.

Mr. Pearlman: Mr. Chairman, I am advised that there has been some prior criticism that the withholding would be unduly burdensome and that was the criticism to the prior proposals but this bill has been revised to relieve that burden.

We believe that probably that criticism is properly addressed in this bill.

The Chairman: I would hope that maybe Treasury or the Joint Committee might check that language with Congressman Gibbons. He suggested that it would be burdensome. I have heard that argument used on withholding and it was fairly effective.

Senator Symms: Any tax treaty problems with it?

The Chairman: Tax treaties?

Senator Symms: Is there any tax treaties with foreign countries or some reason?

Mr. Pearlman: Your question was would this create a problem under this?

Senator Symms: I was curious of why it is that it always gets knocked out. It seems so logical.

Mr. Pearlman: I have not heard that it was a treaty problem, Senator.

Mr. Wetzler: I think in the past there have been transition rules to deal with the treaty questions that are raised.

Mr. Belas: Also the original substantive legislation that was passed in 1980 specifically overruled inconsistent treaty provisions.

The Chairman: I think it is worth looking at and putting back in there.

Maybe we could go to the tax compliance measure.

Senator Symms: How about number "I", Mr. Chairman?

The Chairman: Let's do tax compliance and then "I" and we will just leave "G".

Are these tax compliance measures primarily the ones that result from hearings by Senator Grassley's committee?

Mr. DeArment: Yes, they do and further work with the Treasury staff and the Joint Committee staff. The proposals outlined as exhibit F are designed to deal with areas of the compliance gap that were not addressed by last year's compliance legislation, principally some new tax shelter compliance problems, compliance problems relating to illegal source income and third, the overstatement of deductions.

We add new reporting requirements and targeted amendments to deal with the promotion and sale of tax shelters, abuse of tax shelters and a reporting requirement designed to deal with individuals with substantial illegal source income who spend that income in cash in large cash purchases in excess of $5,000.00.

The Chairman: Does it have any revenue impact?

Mr. Wetzler: I think our estimate is that over the three year period this would pick up about $300 million dollars keeping in mind that it is hard to estimate the positive revenue impacts that come from a lot of these compliance provisions. There is probably some revenue here that we are not able to estimate but we try to be conservative.

The Chairman: Now does Treasury support these changes?

Mr. Pearlman: Yes, we do, Mr. Chairman. Again we do not look at these changes as revenue raisers.

The Chairman: Sort of neutral.

Mr. Pearlman: They are insignificant. We don't look at them as raising any significant revenue.

The Chairman: But you are not opposed to compliance?

Mr. Pearlman: We are very supportive of compliance.

The Chairman: Good.

Senator Symms: Mr. Chairman, could I ask a question about the $5,000.00? The proposal says that the committee may wish to consider recommending American Institute of Certified Public Accountants that anybody who pays cash in the course of a trade or a business that it has to be reported to the IRS. Is this for drug enforcement? What is the purpose of this?

Mr. LeDuc: Senator, last year we had no proposals that dealt with individuals with large drug income or large gambling income or other illegal sources.

The conclusion of the staff was that to catch those guys we catch them when they bring the money back into the system. So if someone walks in to buy a new car and pays $10,000.00 or

$15,000.00 in cash and we are not talking about checks or other equivalents, if he walks in and pulls dollar bills out of his wallet, the car dealer would be required to report that purchase to the Internal Revenue Service. The threshold that was suggested in the write-up was $5,000.00 but it is directed against the illegal source incomes, Senator.

The Chairman: Could he bring in $4,000.00 one day and $4,000.00 the next?

Mr. LeDuc: You would integrate a series of transactions.

Mr. Pearlman: Mr. Chairman, just for completeness let me note that we have some problems with a couple of these compliance items. I think they can be worked out with the staff. I don't want to mislead you.

Senator Symms: Used car dealers would love this. You could buy one car for $4,900.00 today and then go trade it in and pay $4,900.00 difference tomorrow and trade it in the next day for $4,000.00 difference and pretty soon you could trade it in for $4,000.00 you have yourself a Cadallac.

The Chairman: That's right.

Senator Symms: It is going to be hard to enforce. That is the point I wanted to make. What you are really saying is that the goal of the IRS is to get is on a completely credit card and a paper trail so no matter whether you are honest or dishonest, they can track you right down to the last cent of income you earned and the last cent you spend. That is really what we are doing here.

There are a lot of little, old honest people out there that actually save cash and then go spend it.

The Chairman: They won't have any problem, will they?

Mr. Stretch: Senator, the staff is aware of the criticisms that you make and are very sensitive to them. There is a lot of validity to your concerns. We felt that since the American Institute of Certified Public Accountants has criticized the Congress for not taking this step and the New York State Bar had criticized Congress for not taking this step that it should be something that is brought to the attention of the committee and see if we could work out some of these problems that you raise.

Senator Symms: That is the one thing that we have to remember though. The IRS's goal is to have a paper trail for everybody. Now I don't blame them for wanting to catch the drug dealers. I wish there was an answer to that. I think that means that we have to get some meat hooks out here and hang them up on the street poles. I think we would have a better chance of solving that problem than the way we are going at it. They are just going to keep paying people off.

Mr. Pearlman: Senator, let me just point out that this is not an Internal Revenue Service or a Treasury position. We too are concerned as you are.

The Chairman: Let's try to get it all together. You are not talking about changing the color of the money or anything?

Mr. Pearlman: Not in this bill, right.

The Chairman: Would you like to change it?

Mr. Pearlman: I would like blue.

(Laughter.)

Senator Symms: Pretty soon we had better change it to red. It would be more appropriate.

The Chairman: If you want to get the amendment ready, I will offer it if you want to change colors.

Senator Symms wants to go to number "I" and I would like to go very quickly, go to "I" and then let's do "G" and "K" and again I would indicate that what we have done is list on the agenda some areas with some options which may or may not be any good but at least we think they are areas that we ought to address.

Who is in charge of "I"?

Mr. DeArment: Jim.

Mr. Wetzler: I will explain it.

The Chairman: Quickly.

Mr. Wetzler: There has been criticism of the graduated rate structure on the grounds that the very big corporations get benefits of the corporate rates and the theory of "I" is that it would phase out the benefit of the graduated corporate tax rate so your first $100,000.00 of income is your income went up from $100,000.00 to $300,00.00.

The Chairman: I think the criticism is that we may not be getting the big corporatations. Is that your problem, Senator Symms?

Senator Symms: Yes. My problem with that is if corporation "A" makes say $50 million dollars a year taxable, pre-tax profits that they pay taxes on and corporation "B" makes one million dollars or $500,000.00 to make it more appropriate, then the percentage of tax increase that you are going to put on corporation "B" that makes $500,000.00 is a much higher percentage tax increase than it is on the corporation that makes a big profit.

Mr. Wetzler: That clearly is one feature of this option.

Senator Symms: I am thinking of the guy who is a small businessman out here that has a family corporation. They are going to view this as a tax increase?

Mr. Wetzler: Right.

Senator Symms: I don't know how much revenue you are thinking about raising.

The Chairman: I would just say to Senator Symms that I suggested earlier this morning that they need to do some more work on this.

Senator Symms: Maybe you could take a look at any corporation that had over 500 stockholders or something. I don't know. That is just a thought. That was one on the water law, any corporation that had over 25 stockholders. I thought that was too low a number because there are a lot of small corporations that might have that many stockholders but what you are trying to get at is the massive corporation that is doing a billion and a half dollars a year or something that there isn't any reason why they shouldn't pay and they probably wouldn't even know the difference is what you are really saying.

I think that there are a lot of people out there that are going to notice the difference. I think we ought to be cautious of that.

The Chairman: I think that is a valid criticism and concern. Without getting into it more now because I want to do the other two and I have a 12:30 luncheon.

Mr. Wetzler: Should I try number "K" here? This only affects the big people.

The Chairman: Is this the one that we have issued the report on?

Mr. LeDuc: Yes, Mr. Chairman, it is.

The Chairman: Now we have a hearing scheduled on this provision when?

Mr. LeDuc: On October 24.

The Chairman: So I think without getting into detail because it is very complicated and it is an 11-month study, is that correct?

Mr. DeDuc: That is correct building on about eight years of study by some private groups, Mr. Chairman.

The Chairman: You have had a lot of input from the ABA tax section and the New York Bar. I think probably we ought to have the hearing on this before we get into any discussion. The report has been issued. Is that correct?

Mr. LeDuc: It has been issued and has been given to all members of the committee.

The Chairman: The hearing is scheduled for when?

Mr. LeDuc: The twenty-fourth of October, Senator.

The Chairman: Let's just circle that one that we haven't discussed it in the committee but we will obviously at the committee hearing. That leaves number what?

Mr. Wetzler: There is the section 1231. I think that is the last one, number "G". The problem is so-called section 1231 of the Code deals with gains or losses on sale of property used in businesses. There the deal is if you have a gain it is treated as a capital gain but if you have a loss, it is treated as an ordinary loss. The problem is as we know corporations have both gains and losses and recognizing the gains and losses in alternate years taking the gains as long term capital gains and the losses as ordinary losses.

What the provision does would suggest that the losses on these assets should be capital losses which means they wouldn't be deductible against ordinary income. That would address that problem of these corporations recognizing their 1231 gains and losses in alternate years.

The Chairman: How does the Treasury view that? That is not a big revenue difference, is it?

Mr. Wetzler: This would amount to about a billion dollars over the three years. There is a fair amount of money involved in it.

Mr. Pearlman: Treasury has visited this issue before some years ago. If I understand the proposal, it would make all gain or loss eligible for capital treatment without recapture. I think we have some concern about not subjecting gains to the recapture rules. This is one that we would like have some further study on.

Mr. Wetzler: I think what we mean here is just to convert the losses that are now ordinary into capital losses?

Mr. Pearlman: I think we need to talk about this with the Joint Committee.

The Chairman: There may be other committee members that would like to ask questions about it, too. We wanted to raise it again in public session. There may be a lot of objection to it.

Are there any other areas that are not on the agenda that we need to make -- I guess we can discuss that later and issue another agenda and scare more lobbyists. We have completed at least the public discussion of the issues on the agenda. As I understand, public property leasing there are still a couple of concerns in the foreign area, is that correct?

Mr. LeDuc: That is correct, Mr. Chairman, and some real property issues that remain outstanding as well as transition concerns.

The Chairman: Right. I have had a number of letters come to me directly concerning transition rules and I have transmitted all of those to committees.

Mr. LeDuc: We have assembled a very substantial file.

The Chairman: We have finished the spending reduction. We have gone over the spending reduction. In other words, we have gone over not only the staff's suggestions on spending but also those recommended by the Administration, have we not?

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

The Chairman: We would be in a position when we get back to start on the spending side and start voting not only on what the budget committee suggests but spending reductions beyond the $1.7 billion dollars over a three-year period.

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

The Chairman: And also in a position that based on the comments here this morning maybe of working out a package of some kind that might have an impact on the deficit. There seem to be a lot of people around here who are concerned about the deficit. I hope that without distressing anybody too much we can deal with that.

Senator Symms: Mr. Chairman, I know you are trying to leave and I don't want to delay it but I would like to just say one other thing. I hope the staff and the committee would carefully look at without just automatically rejecting it out of hand as just a typical unrealistic proposal and I think it was voiced very clearly here this morning that there is a lot of concern in this town for the fact that we are taxing people about 19 percent of the GNP and most people seem to think throughout the country that that is a fairly high level but that we are still spending 25 percent of the GNP and that is creating an enormous problem and there is a big cloud hanging over the recovery as a result of it.

I hope we won't reject out of hand that the power and the leadership that this committee could exert if we would just simply refuse to move a bill to raise a debt ceiling until people in this Congress and the White House belly up to the bar to cut spending.

We could solve this problem by the first of January. I know it sounds very radical and dramatic but it could be solved very easily. For example, if we started out by cutting everybody's pay who gets a check from the U. S. government by about ten percent starting with the President and everybody else including all beneficiaries of all government programs we could straighten this thing out in a very short time and then go back and start making equality measures to fix those people who are in a most disadvantaged place.

As long as we continue at the rate we are going and I hear this argument in this committee this morning, it is the best argument I have heard for us to do something dramatic in this town for a change instead of just going along and watching the country slide off into two trillion dollars and three trillion dollars. I don't know how big the budget was when you came to the Congress, Mr. Chairman, but when I came it was $200 billion dollars. Revenue was about $200 billion dollars and spending was about $200 billion dollars. When it was about two or three billion over we used to raise a ruckus over this that we are borrowing too much money.

Now we are talking about spending interest to pay on the debt. Soon it will be up to $200 billion dollars. I think there is a point here in time and I think we are about there that we should just simply refuse to raise the debt ceiling and grant the President the inordinate ability. He can't spend money he doesn't have. We no longer have the temporary debt and just work on a month-to-month basis to solve the cash flow problems and pay what is important first and string out the rest of the payments. I think we would surprised at how well it would work.

It worked for New York City. It worked for Chrysler Corporation. It worked for people in the private sector all the time. There is no reason why we couldn't work it around here. I hope the committee will take a look at it and not reject it out of hand. There are some very good positive arguments why we should just simply not extent our debt any further.

The Chairman: When is that going to be necessary? Maybe it is necessary according to Senator Symms.

Mr. DeArment: We believe that we will reach the debt limit sometime later this month so that we are going to have to take action this month on the debt limit.

The Chairman: What is the date?

Mr. DeArment: October. By the third and certainly by the fourth week of October.

The Chairman: If things are happening as rapidly as I read in the Post this morning from the Treasury Secretary maybe we will get another month or two. Perhaps Treasury can respond? Do you think the thirty-first is --

Mr. Pearlman: Senator, the only thing I can do is get you that information but I don't have that at hand.

The Chairman: We are going to do our best in this committee to provide some leadership. We may not have the votes but everyone is going to get a chance to match their rhetoric with performance and we will be meeting again.

There is a list a yard long of things the members want to add to the bill that would cost money. I assume we have all agreed this morning to just drop all those because we have all made these speeches about the need for deficit reduction and not to raise taxes.

If anybody feels constrained to raise any of those, we can take them up later except for that one thing on wheelchairs, we want to take care of that one.

Thank you.

[Whereupon, at 12:50 o'clock p.m., the committee meeting was adjourned to reconvene at the Call of the Chair.]

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