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**UNITED STATES SENATE**

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**COMMITTEE ON FINANCE**

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**MARKUP SESSION**

Washington, D. C.  
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## MARKUP SESSION

THURSDAY, NOVEMBER 17, 1983

United States Senate,  
Committee on Finance,  
Washington, D. C.

The Committee met, pursuant to recess, at 10:25 a.m., in Room SD-215, Dirksen Senate Office Building, Hon. Robert Dole, Chairman, presiding.

Present: Senators Dole, Durenberger, Pryor, Long, Armstrong, Matsunaga, Baucus, Heinz, Packwood, Danforth, Bradley, Grassley, Wallop, Chafee, Bentsen, Moynihan, and Symms.

The Chairman. I wonder if we might--if you have the information that Senator Heinz requested on changing the 65 percent to some lower number on the labs.

Ms. Burke. Mr. Chairman, we were asked to have cost estimates prepared for two different possibilities. One was a change in the cost-sharing proposal--

The Chairman. We are not going to take any action, but she did want to give the numbers she has.

Ms. Burke. We have asked for estimates on two different issues. One was modification of the labs and the one was Medicare cost-sharing proposal.

1 With respect to the lab proposal, we have estimated for  
2 both inclusion of hospital based labs and rates, were you to  
3 drop the prevailing from 65 down to 60, and we have it by  
4 percentage points. Were you to include the hospital based  
5 labs and drop the percentage of prevailing to 63 percent, we  
6 would have a savings over a three-year period of time of \$556  
7 million versus the current proposal which is 320 million. So  
8 it is an addition of about \$200 million to reduce the prevail-  
9 ing and to include hospital based labs. We have numbers for  
10 any percentage. So we can give you estimates for each.

11 The Chairman. Why do you not do that?

12 Ms. Burke. If we were to drop the prevailing to 64 per-  
13 cent, the three-year savings would be \$528 million as compared  
14 to 320. Were we to include hospital based labs and drop the  
15 prevailing to 63, the savings is \$556 million. At 62 percent,  
16 \$584 million. At 61 percent, \$612 million. And at 60 percent  
17 \$640 million.

18 The Chairman. Was there additional information that  
19 Senator Heinz requested?

20 Ms. Burke. Those were the lab options for both inclusion  
21 of the hospital and the drop in the prevailing.

22 With respect to the cost-sharing proposal, which was  
23 described to the Committee yesterday, we have another proposal  
24 which has been costed out. If the Committee will recall, the  
25 proposal we described would provide for cost sharing on day two

1 at 6 percent and then drop to 5 percent on day 15. We have  
2 costed out a proposal which would place a 3 percent cost  
3 sharing on all days. A comparable proposal with a \$2,500  
4 out-of-pocket limit for the elderly and the savings over a  
5 four-year period of time are 2.7 billion as compared to 3.2,  
6 which was the original proposal. So that would produce the  
7 size of the cost sharing and provide for an out-of-pocket  
8 limitation on expenditures.

9 The Chairman. Are there any other areas?

10 Ms. Burke. No, sir. Those were the two main areas.

11 Senator Durenberger. Well, Mr. Chairman, while I am not  
12 opposing this, yesterday when you were busy I responded that  
13 I had expressed to some interest in this Committee for income  
14 testing Part B and presented that as either a revenue neutral  
15 option or some revenue saver. So I toss that into the pot.

16 Senator Heinz. Before you proceed with that, let me ask  
17 Sheila one factual question.

18 Sheila, the numbers you provided, are those based on a  
19 two-year plan rather than a three?

20 Ms. Burke. That is correct.

21 Senator Heinz. We could save a good deal more money if  
22 it were three years.

23 Ms. Burke. That is correct.

24 Senator Heinz. Why do we not want to make permanent?

25 Ms. Burke. The original proposal provided for a two-year

1 in part because of the Committee's desire to reexamine the fee  
2 schedule when more information became available.

3 With respect to fees and the levels that would be most  
4 appropriate once information on lab fees were made available,  
5 we suggested that we come back and look at that. But to limit  
6 the proposal until we have had the opportunity to achieve that.

7 Senator Heinz. We could look at three years. How much  
8 more would we save, Sheila, if we did it for three years?

9 Ms. Burke. I would have to have them give us the last  
10 year.

11 Senator Heinz. I think it is a pretty good chunk of money,  
12 maybe as much as a quarter of a billion dollars.

13 Ms. Burke. We could certainly get that.

14 Senator Heinz. I do not want to delay the Committee, but  
15 there is a lot of money there.

16 The Chairman. Are there any other questions on any of  
17 the spending areas? Anybody want to add any more to the spend-  
18 ing areas or request that we modify any provision?

19 Senator Danforth. Mr. Chairman, I would just renew the  
20 point yesterday on whether we could mirror on what we did on  
21 the social security--in effect, means testing social security  
22 on Medicare. That was raised with the staff yesterday. I  
23 wonder if they have any views.

24 The Chairman. Have you had a chance to look at that?

25 Ms. Burke. Senator Danforth has suggested a proposal that

1 would in effect apply for tax purposes the actuarial value of  
2 the Medicare benefit. We have available what the actuarial  
3 values would be. As I understand it, the proposal would pro-  
4 vide for half of that to be considered as income to an indi-  
5 vidual. In 1984, we assume the actuarial value of Medicare  
6 would be approximately \$2,389 per year. The proposal would  
7 apply for half of that to be considered as taxable income for  
8 those individuals whose incomes are in excess of \$20,000,  
9 which is comparable to the social security provision. The  
10 Joint Committee has not had an opportunity to run the revenue  
11 estimates on that. But that is the principle of the proposal.

12 The Chairman. Have we had any hearings on it?

13 Ms. Burke. No, sir.

14 Senator Danforth. Is it not the identical principle that  
15 was put in place on social security?

16 Ms. Burke. The principle is to consider incomes for  
17 individuals that have incomes over a certain percentage. This  
18 inputs a value to Medicare and considers it as income.

19 Senator Danforth. That imputed value, that is not guess-  
20 work. It is, in the actuarial science--if an individual were  
21 to go out and buy a year's worth of Medicare coverage, the  
22 cost for that individual for such a premium would be \$2,000,  
23 or whatever.

24 Ms. Burke. That is correct, and that value is adjusted  
25 annually as the rates in the program go up.

1 Senator Danforth. I think that the figures we were look-  
2 ing at yesterday indicated something like maybe \$7 billion  
3 over the period of time that we are considering. Would that  
4 be in the ball park in your opinion, Sheila? Does that sound  
5 reasonable?

6 Ms. Burke. I am actually not in a position to guess. The  
7 numbers the staff was using were '82 estimates. In 1988, the  
8 value would be about \$3,600. We would want to look at the size  
9 of the population and what that would do. That guesstimate  
10 was based on old numbers, but it would certainly be a fairly  
11 sizable number.

12 Senator Long. I hope it is not what it sounds like to me,  
13 because, for whatever economic merits it has, it has a politi-  
14 cal burden and I think it is absolutely impossible. For  
15 example, some fellow gets sick, a man or a woman, this person  
16 gets sick, has to go to the hospital, up there in intensive  
17 care in a coma, not knowing whether living or dead for about  
18 a month, and by the time they come out, they have \$20,000  
19 worth of medical services. Their life has been saved but  
20 their income has not been moving on during that time. Then  
21 the government says, see, we provided you with \$20,000 worth  
22 of health services and saved your life, and now you made a lot  
23 of money so now we will tax you 30 percent on top of that, and  
24 that will give us \$6,000.

25 Senator Danforth. That is not the proposal.

1 Senator Long. I would hope not.

2 Senator Danforth. That would be a terrible proposal.

3 The proposal is to say if a person were to go out and buy  
4 insurance, health insurance, the cost of the health insurance  
5 would be X dollars and not because of the actual health care  
6 covered by the insurance, but because of the insurance itself,  
7 is something that can be determined. And for people who are  
8 in the same income levels that we put--that social security  
9 tax should also be covered in Medicare. So you are not saying  
10 if someone has \$100,000 in medical costs, that is what you are  
11 taxing. You are only saying the value of the insurance  
12 premium.

13 Senator Long. That sounds better. Glad to have that  
14 enlightenment on the subject, Senator.

15 The Chairman. I think there is one difference in the  
16 imputed value of social security. Social security recipients  
17 receive cash. Medicare recipients receive insurance. Social  
18 insurance recipients receive cash to pay the tax, but the  
19 Medicare recipient receives insurance coverage, not cash. I  
20 am not certain about this proposal. I am not certain about  
21 anything today, but it is one I think maybe we ought to look  
22 at.

23 Are there any other questions on the spending side?

24 If not, I want to get back to certain add-ons, why  
25 certain members' proposals were not included. I have asked Mr.



1 Chapoton to respond to some of those that were not added.

2 Are you ready to do that, Buck?

3 Mr. Chapoton. Yes, sir.

4 The Chairman. I understand also, Mr. Brockway, the add-  
5 ons would be about 1.6 billion in costs, without any offset.  
6 You mentioned a possible offset.

7 Mr. Brockway. Within it, the add-ons generally would be  
8 about 1.6. But there is one item in the package that is  
9 dealing with industrial development, in the outline, that  
10 would basically make the entire add-on package at the moment  
11 approximately revenue neutral. So the way it stands, the  
12 document that was handed out, that entire package in the  
13 aggregate would be roughly revenue neutral.

14 The Chairman. That would assume that the changes sug-  
15 gested and the IDB were approved.

16 Mr. Brockway. That is correct.

17 The Chairman. Without that offset, it is 1.6?

18 Mr. Brockway. That is correct.

19 The Chairman. You noted your objection to about seven or  
20 eight yesterday.

21 Mr. Chapoton. That were in the package. There are  
22 others.

23 The Chairman. Has there been an opportunity to modify  
24 any of those to save Treasury?

25 Senator Matsunaga, have you taken care of his problem?

1 Mr. Chapoton. That was taken care of. In the restric-  
2 tions in the proposal, we will accept that.

3 The Chairman. What about the foundations? Can we cover  
4 those foundations? Senator Bentsen has an interest, Senator  
5 Armstrong, Senator Percy, Senator Durenberger. Can that be  
6 covered with some generic rather than just specifying the  
7 foundations?

8 Mr. Chapoton. There is Option 3 in the proposal, I guess  
9 would be a generic.

10 The Chairman. What does that do?

11 Mr. Brockway. Option 3 in the writeup is just to list  
12 those particular foundations that are deemed to be in need of  
13 relief from the excess business holding provisions and just  
14 structure it for each one of those. If you went to a generic  
15 test, you could have either tighter or looser tests. You  
16 would need a relatively loose test to pick up all of the  
17 various foundations that have been suggested. One type of  
18 thing that people have suggested is that for pre-1969 foun-  
19 dations, to allow them to maintain a business if there were  
20 no interlocking directorate between the two--the foundation  
21 and the business owned by the foundation, and if there are no  
22 interlocking officers of the two, there are suggestions in  
23 that area that were considered, at least in the House, to say  
24 that if you did maintain an excess business holding--in other  
25 words, a foundation owned a corporation, you would have to

1 have some higher standard on payouts by the foundation. Right  
2 now you have to have a 5 percent payout, maybe requiring that  
3 excess business holding itself to have 7-1/2 percent payout,  
4 as one of the levels that we talked about in the House. That  
5 would allow you to maintain excess business holdings, but  
6 have a higher standard of how much that business holding would  
7 have to pay out. Then you would have to look at the particular  
8 foundations that you were concerned about. But we could  
9 structure a rule, if we were sure what foundations the Commit-  
10 tee felt would be important.

11 The Chairman. Let us start down with Senator Armstrong.

12 Do you still have an interest?

13 Senator Armstrong. Yes, Mr. Chairman, we do. I am not  
14 entirely up to speed about the nature of the options, but it  
15 appears to me that maybe the easiest and most equitable thing  
16 to simply adopt a generic amendment of some sort that would  
17 relieve all of these foundations. Senator Durenberger has a  
18 problem with one of his. I think Senator Bentsen has one.  
19 There are maybe a dozen around the country where there is  
20 that amendment, and maybe we can handle them all in one.

21 Mr. Belas. We have looked at in our staff on the Joint  
22 Committee a number of potential problems brought to our  
23 attention by the Committee and other members, and none of the  
24 generic rules that have been suggested, either on the Senate  
25 or House side, would take care of all of the problems. For

1 instance, some foundations have rules that will have interlock-  
2 ing directorates, even a small amount would be disallowed under  
3 any of the major suggestions. Additionally, a number of  
4 foundations just would not be able to meet--or would be very  
5 reluctant to meet the increased payout rules. It seemed to us  
6 that if you do a generic rule, we will still have to, on a  
7 case-by-case basis, put in special rules for certain founda-  
8 tions.

9 The Chairman. Would Treasury object to that?

10 Mr. Chapoton. Yes, Mr. Chairman. We have been over these  
11 individual cases and we have concluded that there is not just-  
12 ification for change, with the exception of--in each of these  
13 cases, the argument is made for some special reason the  
14 business held by the foundation is important. And when we  
15 examine it, we think the importance is not the charity, but  
16 the importance is for some other purpose. The Congress decided  
17 in 1969 that the holding of businesses by--and running of  
18 businesses indirectly, through the ownership of the controlling  
19 interest, diverted interest from the charitable activities and  
20 gave opportunities, whether intended or not, for self-dealing,  
21 and therefore the Congress decided over the long term,  
22 private holdings, business holdings should not be permitted  
23 by foundations. A lot of foundations, a great majority of  
24 foundations have complied with that requirement, have disposed  
25 of their businesses, and we find difficulty in making

1 exceptions now for those that have not complied and we think  
2 the rule adopted in 1969 was a sound rule.

3 The Chairman. It would be up to those that have specific  
4 cases to meet that burden.

5 Senator Durenberger. Today is the day we were going to  
6 have hearings on foundation law reform, by coincidence.

7 I know several of us had specific problems. The one that  
8 I kept bringing up year after year after year, I think  
9 Treasury has been in the process of resolving it. It involves  
10 a bank holding company and the House language just recognizes  
11 the fact that regulations are being adopted in that area. But  
12 in the larger context, Pat Moynihan and I have S. 1857 which  
13 we would recommend to you which deals with the deductibility  
14 of gifts to foundations, deals with the definition of a family  
15 member, and some expenditure responsibility rules, abatement  
16 of first level penalty rules. What the House did is fairly  
17 comparable to this. We were going a little farther than the  
18 House went. For purposes of making some decisions today, I  
19 think we would be comfortable with what the House did, with  
20 one exception, which I have discussed with Buck, which is they  
21 put something on a 15 percent limitation on administrative  
22 expenses, which was supposed to get as excess payments to  
23 trustees, and it is inappropriate as a general rule, and I  
24 think Treasury is agreeable to take it out. I think we would  
25 like to recommend that as a minimum, without more extensive

1 hearings, that we at least consider adopting what the House  
2 did with the exception of that 15 percent administrative.

3 The Chairman. Senator Armstrong?

4 Senator Armstrong. The only trouble with adopting what  
5 the House has done is it will solve some problems for people  
6 in the House without addressing the Senate--some of the concerns  
7 of at least some of the Senators, and since the Senate has  
8 sent on a number of occasions amendments which we are inter-  
9 ested in and they would not look at them, if we adopt their  
10 language so it is not conferenceable, we will lose their  
11 attention. I hope we can take a bigger bite so we solve those  
12 or at least not reduce the level of attention.

13 Senator Moynihan. I think I agree with both of my  
14 colleagues. May I say that Senator Bradley is also associated  
15 with Senator Durenberger in this matter.

16 I have two questions. One, to the point that Senator  
17 Armstrong raised, and these are always parochial, but a foun-  
18 dation has to be somewhere, the ultimate foundation in New  
19 York, established in 1913, before there were income taxes or  
20 deductions or anything, need another--asks another five years  
21 to comply, thinks the 75 percent and 95 percent distinctions  
22 were not very sensible. And I understand Mr. Chapoton can  
23 accept that.

24 Mr. Chapoton. After our discussion yesterday, I looked  
25 back into that. That is in the House bill. We have no

1 objection on the House side. What it does is say that in  
2 arriving at the test for 20 years, whether you are 20 or 15  
3 years is your--the foundation's holdings in 1969 and this  
4 combines the holding of disqualified persons with the holdings  
5 of the foundation.

6 Senator Moynihan. If that could be included in our legis-  
7 lation, I would appreciate it.

8 Then there is another question. I do not know if this is  
9 the point to bring it up. But let me ask.

10 The President's Committee on the Arts--the President's  
11 Committee on the Arts and Humanities had a three point pro-  
12 posal which the Administration accepted. This was basically  
13 a proposal to increase charitable contributions, and the  
14 first provision was to enable individuals to donate up to 75  
15 percent of adjusted gross income, and the second provision  
16 gave them a longer period of time if they gave--to carry  
17 forward their contributions if they gave more. And the third,  
18 which I think would have to be said was Treasury's price for  
19 agreement, was that you have to hold something five years  
20 before you can deduct that increased value.

21 Now, we are in a bit of a problem here, and it is awfully  
22 late in the session, but I believe yesterday we adopted that  
23 five-year provision.

24 Mr. Chapoton. I do not know if it was adopted, but it  
25 was in the package.

1 Senator Moynihan. We have not dealt with the first two.  
2 I have to tell you the American Council of Museums is very  
3 distressed about the third. It seems to me if we cannot have  
4 the first two, we probably should not have the third.

5 Mr. Chapoton. As I said yesterday, this was part of a  
6 package because we had agreed with the President's Commission  
7 on these points, and I think they were very helpful in  
8 designing the rule that we were concerned about, the gift--the  
9 purchase of property and then giving it to a charity and  
10 claiming a large deduction. The five-year rule that was in  
11 the package yesterday would prevent that. The other parts of  
12 the package were as Senator Moynihan described. I have  
13 pointed out, and somewhat to my surprise, the second part of  
14 the package going to the 75 percent is more expensive than we  
15 had realized. Our estimate is that it would cost 142 million  
16 in '84, 318 in '85, and then drop off to a little less than  
17 a hundred in '86.

18 The Chairman. Then you go to some lesser figure?

19 Mr. Chapoton. The 15-year carryover has very little cost  
20 to it. In principle, we have no objection. We support those.

21 The Chairman. Why do we not try to put together some  
22 little package?

23 Senator Moynihan. Can we do that? If we are going to  
24 have the third part, or some part of the first two--these are  
25 good causes and it is the President's Commission.



1 The Chairman. I am sure it is doing great work. You can  
2 probably round that off, round it down.

3 Mr. Brockway. We will come back with something that is  
4 basically revenue neutral.

5 Senator Moynihan. You will pick up something in the end.

6 Mr. DeArment. We may have to do something with the mini-  
7 mum tax.

8 Senator Moynihan. Revenue neutral would be our object.

9 Mr. Brockway. Instead of going up to 75, maybe 65,  
10 something in that area.

11 Senator Moynihan. I think that is the way to think about  
12 it.

13 Thank you, Mr. Chairman.

14 Senator Durenberger is our leader in this matter.

15 The Chairman. What about the foundations? I think in  
16 fairness to Senators, we have not had that much success in  
17 the House. We would go over there with a handful, and not a  
18 large handful, of areas that our members feel should be  
19 changed, and they have always told us we have not had hearings.  
20 Now they have had hearings and they did try to reach agreement.  
21 And I do not know what Treasury's attitude would be if we go  
22 back with the same package that we go back with on an annual  
23 basis.

24 Would that cause you great heartburn?

25 Mr. Chapoton. No. I have stated our concerns. I think

1 the problem is limited in the sense that almost all are dealing  
2 with pre-'69 holdings and so the breadth of the problem is  
3 limited.

4 Senator Long. Mr. Chapoton, I want to ask about the  
5 amount of money the foundations are holding and how much  
6 revenue they are bringing in.

7 Can you give me that information? How much assets are  
8 these foundations holding?

9 Mr. Chapoton. I do not think I have that. We have know-  
10 ledge on that and I can get that for you.

11 Senator Long. Can you not give me a rough guess?

12 Mr. Chapoton. We will get that information. It is  
13 several billion dollars.

14 Senator Long. I would guess that their assets are more  
15 than several billion dollars.

16 Mr. Chapoton. You are probably right. We can count off  
17 several that are close to a billion, but after you get below  
18 the top 15 or 20, it probably drops off pretty quickly.

19 Senator Long. I would just like to know this, particularly  
20 for those that do not qualify as public foundations, how much  
21 do they have in the way of assets and how much annual income  
22 do they have? The reason I ask the question is that some  
23 years ago, we put a tax, very small tax, on foundations, and  
24 by the time we managed to get it through, it was nothing more  
25 than something to keep us informed as to what they are doing.

1 One reason we did was at that particular time there was some  
2 disclosure about what the foundations were doing. One minor  
3 thing that was discussed, two affluent men that play golf at  
4 the same club together, both of them have a little foundation  
5 to provide for education. Mr. A, he sends Mr. B's children  
6 to college, and Mr. B sends Mr. A's children to college. With  
7 that arrangement, they were both--treating the same thing as  
8 if they were using a private foundation to educate their own  
9 children. While we did not want to be social outcasts in  
10 those areas by exposing the names, those type things were  
11 going on, and no one had any doubt about it. We felt it would  
12 not hurt them to pay a modicum of taxes. They came back to us  
13 and they kept pressing those that were on the committee and,  
14 step by step, they pushed to get it no revenue at all. We are  
15 hard up for revenue. I would think those private foundations  
16 could pay a little something, not expecting much.

17 Mr. Chapoton. The logic, or the argument for the initial  
18 tax on investment income of foundations adopted in 1969, which  
19 was 4 percent, was that they ought to pay for the cost of the  
20 audit process by the Internal Revenue Service. The very  
21 stepped up process was instituted as part of the 1969 legisla-  
22 tion. Subsequent to that, they made the case, and we agreed,  
23 that the amount collected under the 4 percent tax was in  
24 excess of the amount required to audit the foundations, and it  
25 was subsequently reduced to 2 percent. It was not a general

1 type revenue tax.

2 Senator Long. If you are just getting me the figures,  
3 how much assets they have and how much annual income they  
4 have--I frankly find myself thinking--it is one thing when  
5 you are talking about some foundation where it is a public  
6 foundation, like the Salvation Army or the Red Cross. It is  
7 another thing where some private foundation--and let us face  
8 it, many were organized for the purpose of tax avoidance more  
9 than the purpose of charity, some of which did not even have  
10 a record of giving anything to charity up until we started  
11 reforming those laws. It would seem to me it would not hurt  
12 to pay a little something to support this government which  
13 makes the foundations possible.

14 If you would give us the figures, it might help.

15 Mr. Chapoton. They are in the GAO report.

16 Senator Long. If the government were not hard up for  
17 money, I would be the last one to suggest they pay even a  
18 penny, even the cost of seeing what they are up to. But if  
19 the government needs the money, it seems to me they might  
20 contribute a little something.

21 Mr. Chapoton. I think, as you remember, there was the  
22 1965 report on private foundations, the abuses, and there  
23 certainly were--it received a great deal of attention, which  
24 led to the reforms in the 1969 Act. The '69 Act, we think,  
25 does a basically good job and we reviewed it in connection with

1 the hearing from the House side, and we do not want to dis-  
2 mantle the '69 Act, but we think it does a pretty good job  
3 of policing those problems.

4 Senator Long. In terms of paying, they could pay a  
5 little something. And if I have the information, I can  
6 judge better.

7 The Chairman. As I understand, Senator Bentsen is on  
8 his way, but there was some House language, I think Senator  
9 Armstrong has it available--was that adopted by the House?

10 Senator Moynihan. Mr. Chairman, I want to say it was.

11 The Chairman. The House language we were talking about  
12 would cover all of the problem areas on the foundations?

13 Mr. Brockway. If this is the proposal dealing with  
14 excess business holdings, it does not. In the House they  
15 basically made no changes dealing with excess business hold-  
16 ings, which is a significant area. They made one or two  
17 relative minor changes, but I think the language may deal with  
18 a proposal that ultimately was not offered, but could take  
19 care of most of these institutions.

20 The Chairman. That is the one that Senator Armstrong  
21 and Senator Bentsen would support.

22 Senator Armstrong. The proposal was developed by Senator  
23 Bentsen, but I understand it would solve all of the founda-  
24 tions. I do not have the paperwork but, in essence, it does  
25 this. It relieves the foundation of the duty to divert

1 themselves and set up certain equitable guidelines. It says,  
2 for example, we are going to retain no self-control, no  
3 interlocking. I think a member of Senator Bentsen's staff is  
4 here, and if I could get his attention, maybe I could get that  
5 paperwork.

6 Mr. DeArment. Even with that generic language, there  
7 were some foundations that were covered in the past that we  
8 would have to do special interest. The New London Day Trust,  
9 they would not be covered.

10 The Chairman. Any others?

11 Mr. DeArment. The Murphy Motor Freight issue is one that  
12 is covered in the House bill that we would want to reaffirm  
13 that language.

14 Senator Durenberger. Could I ask--I do not know if I  
15 asked Buck earlier, are you familiar with what the House has?  
16 If we take out that 15 percent administrative--

17 Mr. Chapoton. Yes.

18 The Chairman. The Treasury has made its position clear.  
19 This is something we will do and we will take care of those  
20 that have been raised in the past as well as the New York,  
21 Texas, Colorado, Minnesota, North Carolina, Connecticut,  
22 Illinois, and there may be others.

23 Senator Moynihan. Could I ask Senator Durenberger, on  
24 the 15 percent provision, I did not get your exchange with Mr.  
25 Chapoton.

1 Senator Durenberger. As I understand it, it was a limi-  
2 tation on the amount of administrative expenses. It was  
3 adopted sort of last minute on reconsideration. Both the  
4 Treasury and some of its proponents said it was one of those  
5 throwing the baby out with the bath water amendment.

6 Mr. Chapoton. The concern was that there was a particu-  
7 lar story about a foundation that if expenses were excessive,  
8 which would be a violation--might be difficult to nail down,  
9 but it would be a violation of State law if they were exces-  
10 sive. That would be the responsibility of the State Attorney  
11 General, and probably a violation of Federal law as well. We  
12 had difficulty putting a cap on management.

13 Senator Moynihan. I thank you for that. Because there  
14 are foundations who, the nature of their work has high admin-  
15 istrative costs. So you do not feel a cap is necessary.  
16 Where there is clearly improper behavior, there are laws to  
17 take care of that.

18 Mr. Chapoton. Right.

19 Senator Moynihan. Thank you.

20 The Chairman. Senator Bentsen.

21 Senator Bentsen. I apologize for being late, but I was  
22 chairing a hearing and Democrats get to do that so rarely, I  
23 had to fulfill that responsibility.

24 As you know, I am deeply concerned about this foundation  
25 provision and want to see us take a generic approach to see

1 that we avoid any self-dealing and avoid the interlocking  
2 directorates. But one point that has to be made is when you  
3 have one of these foundations that is owned--you really do  
4 not have any loss in revenue. So that point is not appreciated  
5 sufficiently.

6 The other point I would like to make, in my particular  
7 case, there is something to be said for having a preservation  
8 of independent newspapers, and I do think that is important  
9 to us, and I think it also involves some of the First Amend-  
10 ment guarantees, under our Constitution, so the case that I  
11 present for that I think is one that we ought to consider in  
12 the generic terms.

13 The Chairman. I agree with Senator Bentsen on both the  
14 specific case he cited and the general need to address the  
15 problem. Why can we not agree to do whatever is necessary to  
16 cover those if it is generic. If not--you mentioned the one  
17 in New London.

18 Mr. DeArment. We can offer a specific rule in addition  
19 to the generic. The generic rule does not take care of one of  
20 the trusts that the Committee-or the Senate has in the past  
21 dealt with, the New London Day Trust.

22 The Chairman. It takes care of Texas, Colorado--

23 Mr. DeArment. The Altman Foundation, the public welfare,  
24 the Sand Springs Childrens Home, the Cafritz, all of the ones  
25 that we have known about before, except the generic language



1 would not take care of New London, and we could fashion some  
2 language for that.

3 Senator Symms. Did you mention the Hut Settlement in  
4 Spokane, Washington?

5 Mr. DeArment. That is not one that I am familiar with,  
6 but if they have an excess business holdings problem, then the  
7 generic rule would take care of them.

8 Senator Symms. Their problem is all of their property  
9 is real estate, as the trustee left it in 1927. Then they  
10 have a 10 percent public support rule. They are between a  
11 rock and a hard spot. They do not want to take public support.

12 You are familiar with it, are you not?

13 Mr. Chapoton. No, I am not.

14 Senator Symms. It was introduced in the House as H.R.  
15 3343.

16 Mr. Brockway. This is not an excess business holdings  
17 problem. It is a question of public foundations--or maybe a  
18 debt financed real estate problem. We can take a look at it  
19 and get back to you.

20 The Chairman. The Mayor of Washington, D. C. is concerned  
21 about some problem. He probably has a lot of problems he is  
22 concerned about. I gave the letter to Rod. What is Mayor  
23 Barry's problem?

24 Mr. DeArment. It is an IDB problem.

25 Mr. Brockway. It is a problem--one of the items in the

1 industrial development bond package is a rule saying that the  
2 industrial development bond limitations that are generally  
3 applicable for for bonds issued by any State or local munici-  
4 pality also apply to the District of Columbia and the  
5 possessions. Under the current rule, these do not because  
6 they are not a State locality, and what the proposal here would  
7 be is say they are subject to some limitations as an industrial  
8 bond in any jurisdiction.

9 The Chairman. In the House bill?

10 Mr. Brockway. It is in the Ways and Means bill, Ways  
11 and Means reconciliation bill.

12 The Chairman. They have not dealt that out in the Rules  
13 Committee?

14 Mr. Brockway. My understanding is it is still a part  
15 of the package.

16 The Chairman. We can take care of any problems there are  
17 in conference.

18 Mr. Brockway. Certainly.

19 The Chairman. I am not certain where we are going here.  
20 At least we raised the question. The record will reflect that

21

22

23

24

25

end 2

1 Senator Bentsen. Before you leave the subject, I want to  
2 be sure, when we deal with this in a generic way, and you take  
3 care of the divestiture problem, I do not see why they cannot  
4 take care of the New England Trust, as far as the divestiture.  
5 They may have some other problems, but I would want the staff  
6 to address that concern.

7 Mr. Chapoton. I have the figures now that Senator Long  
8 was asking for. According to the GAO study, the number of  
9 foundations, and this is 1981, was 31,866, and the assets,  
10 total assets at market value were 50,980,000,000 and total  
11 receipts of nine billion.

12 Senator Armstrong. Is Senator Bradley going to take us  
13 on to an entirely different subject?

14 Senator Bradley. I am going in another direction.

15 Senator Armstrong. Could we be sure we have nailed this  
16 down? I am glad on the Bentsen amendment, but it is not clear  
17 to me whether we have disposed of Senator Durenberger's pro-  
18 posal to add in the text of 1857.

19 The Chairman. What I suggested was, rather than--there  
20 are four or five different areas that we have interested mem-  
21 bers, the staff make certain that they are all in there.

22 Senator Armstrong. You are saying we have agreed to add  
23 that in. If that is the case, Mr. Chairman, I would like to  
24 flag a problem, and ask at some point we come back to it. I  
25 am not ready to do it today, but as I understand it, S. 1857

1 and the House language to which it is comparable says that you  
2 can get a tax deduction for the gift of listed securities to  
3 a foundation, and establishes a threshold of not more than 10  
4 percent of that stock being held by the foundation. But I am  
5 told that it does not adjust the de minimis rule, which is  
6 presently at two percent, and somebody asserted to me that this  
7 going to create a catch 22 situation.

8 I do not represent that to the Committee yet, because I  
9 am not on sound enough ground. But I wanted to mention this,  
10 so I could hold the option open to us, because if what has  
11 been represented to me is correct, we ought to finalize it.

12 Mr. Chapoton. The change in the House bill is to allow  
13 --now under current law a gift of appreciated property to a  
14 private foundation, the charitable deduction is limited to the  
15 cost. The change in the House bill was to say if you gave  
16 stock of a listed company, you could take the fair market  
17 listed value up to 30 percent. We moved it from 20 to 30, and  
18 there was a limit. The idea was it should not be an asset in  
19 which you had a controlling interest.

20 Senator Armstrong. Mr. Secretary, there might be some  
21 confusion. But my understanding is the way that works the full  
22 market value of the stock could be deducted by the taxpayer  
23 if it was a listed stock, but also if the holdings of the  
24 foundation in that stock did not exceed 10 percent.

25 Mr. Brockway. Under present law you are limited to your

1 basis which you give. But this would allow a deduction for  
2 the fair market value if the donor owns less than 10 percent,  
3 not if the foundation does. So the donor can give up to two  
4 percent of the total stock in the corporation, as long as he  
5 owns less than 10 percent.

6 He can give all of that to a foundation, but the founda-  
7 tion -- it counts against its excess business holdings if it  
8 owns more 10 percent. Not to get hit by any rule, you would  
9 give two percent here and two percent there.

10 Senator Armstrong. That is not what I have been advised.  
11 But legal counsel for a foundation which has interest in  
12 Colorado asserts to me that the 10 percent rule would apply  
13 to the holdings of the foundation in the particular stock.  
14 If that is the case, and you do not do away with the de minimis  
15 rule, you create a situation where it would be a catch 22.

16 I am not eager to take the time of the Committee, but  
17 since we were looking at this, I wanted to get this out, and  
18 suggest we come back and look at it after we clarify the  
19 issue.

20 I do not think Senator Durenberger would have an objection  
21 to clarifying that, if it in fact exists.

22 Mr. Chapoton. I would just point out the intent was not  
23 to deal with excess business holdings.

24 Senator Armstrong. As far as I am concerned, we are  
25 beyond that. The purpose of the House bill, as I understand

1 it, of Senator Durenberger's proposal, is to encourage a per-  
2 son that is holding listed securities to donate them to these  
3 foundations.

4 Mr. Chapoton. That is correct.

5 Senator Armstrong. But if the de minimis rule at two per-  
6 cent is not changed, you create a situation in which the  
7 foundation would have to spin those things off, and in many  
8 situations it would result in the change of control. It would  
9 seem you should change the de minimis to 10 percent to match  
10 the 10 percent on the other side.

11 Mr. Chapoton. The argument was we are not talking about  
12 anything close to control. I can see your point, there is an  
13 inconsistency, but if you went to 10 percent, we would really  
14 have a concern on that.

15 Senator Armstrong. I am not in a position to advocate it,  
16 but I did not want to let the issue go through without flagging  
17 it.

18 The Chairman. I want to make certain, what I propose we do  
19 -- we have had four or five different proposals jumping  
20 around the table. I propose we nail those together, we not  
21 repeal present law, but get together with Senator Durenberger  
22 and others that have a specific interest, and make certain  
23 they have been protected, and then bring it back here and pre-  
24 sent it to the Committee, and see if it is satisfactory.

25 Senator Moynihan. For the record, Senator Danforth and I

1 have a measure that involves these matters, and perhaps we  
2 could be in the conversation.

3 Senator Chafee. Mr. Chairman, could I have one more word  
4 on this subject?

5 As I understand it, the House, they have passed legis-  
6 lation on this?

7 Mr. Brockway. It is reported out of the Ways and Means.  
8 It is part of the reconciliation.

9 Senator Chafee. I have some interest in this also. I  
10 would like to contribute those thoughts to Senator Durenberger.

11 Would it be your intention that from this gathering of  
12 thoughts on this matter, we come back with some legislation,  
13 and then go to conference? Is that your idea?

14 The Chairman. That is something I have thought about,  
15 going to conference with this whole package, but we are only  
16 going to go with one or none.

17 Mr. DeArment. We can have a staff meeting, and we will  
18 have the staff of all those who have an interest.

19 The Chairman. Yes. That is our ultimate goal, to try  
20 to work this out, and reduce the deficit, and take care of  
21 members' problems.

22 Senator Bradley?

23 Senator Bradley. Mr. Chairman, I would like to address  
24 a part of the provision in the package that we have been pro-  
25 vided for the extension of the energy tax credit.

1 In particular, I would like to address that portion that  
2 would apply to the Synfuel Corporation. We are permitting tax-  
3 payers --

4 The Chairman. Do we have the right people up there?  
5 Senator Bradley. We are permitting taxpayers who are  
6 receiving loans and assistance from the Synfuel Corporation  
7 to also claim energy tax credits on those loans and loan  
8 guarantees.

9 It seems to me that that is a kind of double dipping, and  
10 since we have already appropriated \$17.4 billion of synfuels,  
11 and have only spent three, then it is really a kind of unneces-  
12 sary tax policy.

13 I would like to ask Mr. Chapoton, would not it be prefer-  
14 able to ask recipients of the synfuels monty to choose whether  
15 they want that money or the tax credit?

16 Mr. Chapoton. This, and part of the package presented  
17 yesterday, would be extension of some credits, and one of those  
18 would be synfuels credit. We have been less than excited  
19 about extension of the synfuel credit.

20 The question of double dipping was mentioned to me. I  
21 have asked the proponents of this, and I have asked for a  
22 letter on this, that the Synfuel Corporation is supposed to,  
23 or does take into account dollar for dollar the tax benefits  
24 in arriving at the loan guarantees and the subsidies.

25 So I do not know quite how they take that into account,



1 but we ought to look at what their position is.

2 Senator Bradley. I am sure they take it into account.  
3 But the basic question is how much Federal subsidy do we want  
4 to give to Synfuels. We have already appropriated \$17 billion.  
5 This would be an additional \$500 million, between now and  
6 1990, and perhaps as much as \$250 million additional subsidy  
7 over and above the 14 billion that the Congress has already  
8 left to apply.

9 And it is just my view that what we should do is say,  
10 look, let them make a choice. We do have a \$250 billion  
11 deficit. They either take the money from Synfuel Corporation  
12 or they take advantage of the tax credit. Why both? I cannot  
13 see any policy reason to do this. It is just heaping more  
14 dollars on Synfuels.

15 Senator Wallop. I think I can answer. It is my proposal.  
16 First of all, let me say that it is not an additional  
17 \$500 million. The Senator mistakes where the money goes for.  
18 A significant percentage, well over half that money, goes to  
19 renewables. It is not all going to Synfuels.

20 I would point out the energy tax credits were first cre-  
21 ated in 1978, and the Synfuels Corporation was created in  
22 1980, and we intended to make those benefits double. The two  
23 forms of credit, the tax credit and the Synfuel Corporation  
24 work well together. The energy tax credit provides the up  
25 front cash that will encourage the capital formation, and the

1 assistance provided by the Synfuels Corporation provides long-  
2 term assistance in the form of either price guarantees or  
3 loan guarantees.

4 Let us make no mistake about it. This amendment comes  
5 from the environmental community that does not want the syn-  
6 thetic fuels in this country developed. That is pretty clear,  
7 given the letters floating around the Capitol. The letter  
8 from the Synthetic Fuel Corporation that Mr. Chapoton spoke  
9 of is now in his hands. You may have it, but let me read it.

10 The Synthetic Fuels Corporation firmly believes that in  
11 fact no double dipping ever occurs. The Energy Security Act  
12 specifically mandates that the Synthetic Fuels Corporation  
13 consider all tax benefits when making awards of assistance.

14 For example, the Act requires that tax benefits be taken  
15 into account in determining that an investor bears substantial  
16 risk of after tax loss, and that is Section 131(q) in the Act.  
17 It also requires the Synthetic Fuels Corporation to consider  
18 tax benefits when determining that it is providing the minimum  
19 subsidy necessary to provide an adequate subsidy for economic  
20 and financial liability. That is Sections 131(t) and 134.

21 In practice, this means that assistance is reduced by an  
22 amount that is quickly equivalent to the energy tax credits,  
23 thus avoiding the double dipping. It appears that virtually  
24 every U. S. synfuels project will require Synthetic Fuel  
25 Corporation assistance.

1 Passage of Senator Bradley's amendment will mean that the  
2 energy tax credit will become a deadletter, contrary to the  
3 earlier intent of Congress, that tax credits and Synfuels work  
4 in tandem to stimulate the production of synthetic fuels.

5 If we were to carry your proposal to its logical extension,  
6 that would mean in those States that also provide tax incentives,  
7 that the Federal tax credit should not be available there  
8 either.

9 Senator Packwood. Let me address myself to that. I  
10 want to make sure, although this relates to homes, and not  
11 businesses -- we have this problem in Oregon. We started an  
12 energy conservation program, and up to a certain portion of  
13 your loan can be to weatherize your home, and the Internal  
14 Revenue Service said if you do that, you cannot have the  
15 normal home energy credit. You have a double problem. For  
16 those that can afford to pay cash, they get the credit.

17 I do not want to get into the situation where any Govern-  
18 ment guaranteed loan is going to cause you to lose credit,  
19 because that is an unfair distinction between companies that  
20 have to borrow and companies that do not.

21 Senator Wallop. That is exactly what it is. Congress  
22 put those credits and the Synthetic Fuel Corporation into  
23 place sequentially, and we recognized, and specifically did  
24 on purpose what the Senator seeks to have us remove now. It  
25 is easy to talk about that when we have a so-called oil glut.

1           If anyone in this room believes that is forever, the argu-  
2 ment is over. What we need to do is we have to stimulate  
3 synthetic fuel production, environmentalists or not.

4           Senator Bradley. I would like to note that it is not  
5 just the environmental community that is opposed to this, but  
6 the National Taxpayers Union is opposed to it. It is opposed  
7 to it because the subsidy to synfuels that already exists is  
8 enough. That is the issue.

9           We have appropriated \$17 billion for Synfuel, appropri-  
10 ated, sitting there. It is waiting, and now we are asking that  
11 we extend a tax credit for these synfuel projects that will  
12 add to the deficit over the next couple of years, \$250 million.  
13 Maybe it does not matter. It is not a big number. But the  
14 fact is it does add to the deficit, and in addition to that,  
15 we have more than enough force in fuels.

16           I yield to the Senator from Colorado.

17           Senator Armstrong. I am not sympathetic to the amend-  
18 ment the Senator suggests, but I am sympathetic to the general  
19 line of his thinking.

20           If I understand what Senator Wallop's amendment does, it  
21 was really an extension of a date.

22           Senator Wallop. That is correct, and the deficit argument  
23 cannot be made, because the sum total of this thing is paid  
24 for. It picks up \$688 million.

25           Senator Bradley. You mean the credit does not cause any

1 lost revenue?

2 Senator Wallop. No. Because we have picked it up with  
3 credit ordering, and that was the whole purpose with this long  
4 negotiation with the Administration, which they have for-  
5 gotten.

6 Mr. Chapoton. Senator, I do remember. That is correct.  
7 We have not been, as I said, excited about any of these  
8 credits. We recognize that there is a lot of support for  
9 them. We have discussed with the proponents of the credits  
10 the possibility of extending them. They have dropped some.  
11 They agreed to the credit ordering rule, which reduces the  
12 cost dramatically. So we have agreed with this package which  
13 does include an extension of the synfuel credits, but for the  
14 first three years, the cost is very low, less than \$100  
15 million.

16 Senator Bradley. So it does cost.

17 Mr. Chapoton. That portion of the package.

18 Senator Wallop. But it is picked up with credit ordering,  
19 which actually picks up \$688 million.

20 Senator Bradley. The energy tax credits in the document  
21 that has been distributed says that over the period of '84-'87,  
22 it loses \$829 million.

23 Senator Wallop. If the Senator would look on, part of  
24 the package is on page 10. You will find the revenue effect  
25 down there, with energy credits, 829 million, and the credit

1 ordering picks up that, and there is one year, '88, which  
2 there is a minus, but the total effect is 688 million. We  
3 pick up money every year.

4 If you start toying with that thing, you will start  
5 destroying what is a good process.

6 Senator Armstrong. I think Senator Wallop is right about  
7 that, but let me say that I think the Senator from New Jersey  
8 is correct, even though I think the tax credit is a proper and  
9 very efficient way to solve the problem.

10 So I support Senator Wallop in that. Even though a large  
11 portion of this projected synthetic fuel occurs in my State,  
12 I think we ought to go back and look at that Synfuels Corpor-  
13 ation, and basically I think we ought to abolish it, and cer-  
14 tainly we ought to rescind some of that \$17 billion.

15 Senator Wallop. I have no quarrel with that, but it is  
16 a different topic.

17 Senator Armstrong. Yes, and the amount we are talking  
18 about in this amendment is very small. I would encourage you  
19 to join with Senator Hart, Senator Proxmire, and a number of  
20 us, that think we went off the deep end in creating that Syn-  
21 thetic Fuels Corporation, and it is vastly overfunded. And I  
22 say that as the Senator from the State that has probably more  
23 to gain from modest expenditures by the Synfuels Corporation.

24 We did go too far, and I think his main point is correct.

25 Senator Matsunaga. In the meantime, I think it is

1 necessary that we extend the present energy tax credits.

2 Senator Bradley. The Senator has no objection to extend-  
3 ing the energy tax credit per se. I would prefer not to in-  
4 crease the level of subsidy to the synfuels industry that  
5 already has a pool of unused appropriated dollars of 14  
6 billion.

7 Senator Wallop. If it were to be that case, I would not  
8 particularly quarrel, but it is not that case. The law  
9 requires them to take care of, and take into consideration  
10 those making the grants. The process of it is simply this.  
11 You get your cash flow from different places. You have to  
12 have a viable project before you can get anything from the  
13 Synfuels Corporation, and you cannot get a viable project,  
14 because you cannot raise the capital until you use these,  
15 and that is why they work in tandem.

16 Senator Bradley. I think the point that the energy tax  
17 credit, as applied to synfuels, might not be losing as much  
18 money on its face because of credit ordering, but would it  
19 not also be the case that if you did have the energy tax  
20 credit, the credit ordering could be used to reduce the deficit  
21 further?

22 Senator Wallop. In that instance you would do violence  
23 to the whole process of developing synfuels.

24 Senator Bradley. Is that not true, it would reduce the  
25 deficit more?

1 Senator Wallop. No. But you would get absolutely zero  
2 synfuel development, which I think is your purpose, but it is  
3 not antional policy.

4 Senator Bradley. My purpose is not to have the industry  
5 reaching into the pockets of the taxpayers, both on the  
6 appropriations side and on the tax side. That is my purpose.

7 Senator Wallop. I have made the point, Mr. Chairman, and  
8 I am ready to vote on it.

9 Mr. Chapoton. Let me just add, if I might, that credit  
10 reordering does more than offset the package.

11 Senator Bradley. Which could lead to a further deficit  
12 reduction of -- where is the number -- \$1.5 billion over the  
13 three year period.

14 The question is do you want to reduce the deficit by  
15 another \$1.5 billion, or do you want to take that money and let  
16 it go to the synfuel industry, that already has \$14.5 billion  
17 they have not spent?

18 Senator Wallop. To do that credit ordering without the  
19 tax credit simply destroys that.

20 The Chairman. Can you restate the question?

21 Mr. DeArment. There is a question about how broad the  
22 policy would go. Is it the loan guarantee -- would you lose  
23 the credit, or is it --

24 Senator Bradley. A taxpayer must choose whether they want  
25 the extension of the energy tax credit, or whether they want  
T.4 a loan or loan guarantee from the Synfuels Corporation.



T. 4  
1 Senator Wallop. Does that apply to DOD grants on solar  
2 as well?

3 Senator Bradley. Things that come out of the Synfuels  
4 Corporation. That law does not subsidize solar energy.

5 Senator Wallop. DOD grants do the same thing.

6 Senator Bradley. If you can put a chunk of appropriated  
7 dollars up to 14 billion for solar or for whatever other  
8 energy you want to promote, I do not have any problem.

9 Senator Wallop. It is apples and oranges. If you want  
10 to be consistent, you have to do the same thing for solar  
11 grants for DOD.

12 Senator Bradley. I would argue the issue is level of  
13 subsidy and the size of the deficit.

14 Mr. DeArment. The proposal is if there is a grant, a  
15 loan guarantee from the Synfuels Corporation for any kind of  
16 activity that the Synfuels Corporation subsidizes--

17 Senator Bradley. Would you give me a list of that?

18 The Chairman. Does this address the Wallop provision in  
19 the add-on?

20 Mr. DeArment. Yes. We extend for synthetic fuels the  
21 affirmative commitment date that is already in the law, and  
22 it would be with respect to those credits, and we also--

23 The Chairman. It is not on the basic energy tax proposal?

24 Senator Bradley. It just relates to the extension.

25 Mr. DeArment. It may relate to biomass--the extension of

1 the affirmative credit rule to biomass.

2 Senator Chafee. Is this prospective?

3 Senator Bradley. Yes. The extension I think begins '84  
4 through '87.

5 Senator Chafee. Suppose you have a company that is  
6 involved in this, and as Senator Wallop said, it estimates  
7 based on the tax credit it is going to receive and, thus, as  
8 I understand his argument, the Synthetic Fuels Corporation, in  
9 making its grant, figures how much the recipient will receive  
10 from the grant. Now you cannot change those rules.

11 Senator Bradley. That is correct, and I would certainly  
12 say to you in response to your point that that taxpayer and  
13 that business person would have to make the same kind of  
14 adjustment that all of those businesses made last year when we  
15 passed TEFRA. It would require the same kind of adjustment.  
16 If the argument is once you put something in the tax law it  
17 can never be changed because people have made projections on  
18 what their return on investment is going to be, then we will  
19 never change the tax laws or close any loopholes. If your  
20 point is whether Congress has the right to review policies and  
21 Congress has the right to determine the size of subsidy to any  
22 particular form of energy, this form of energy having nearly  
23 17 billion already appropriated, and then Congress determining  
24 we should not add on to that--the amendment is perfectly  
25 acceptable.

1 Senator Chafee. I am going your way. Do not drive me  
2 away.

3 Suppose a company is into a deal, a contract with the  
4 Synthetic Fuels Corporation, based on the anticipation and  
5 contract in which they have made their calculations based on  
6 this credit. Would your proposal deny them the credit in  
7 calendar '84?

8 Senator Bradley. If there is a substantial investment,  
9 my guess is no, although the tax credit would not be available  
10 in the outyears--I would say the tax credit is not available  
11 in the outyears.

12 Mr. Brockway. A point of clarification.

13 The limitation you are suggesting, would that apply to  
14 credits that are allowed under the present rules or only under  
15 the rules as extended in this package? What this package does  
16 is extend the energy credit in certain areas, but there are  
17 some credits in present law allowed under affirmative commit-  
18 ment rule.

19 Would your limitation apply to those limitations on  
20 current law?

21 Senator Bradley. It applies to the affirmative commit-  
22 ment.

23 Mr. Brockway. Even affirmative commitments that are  
24 allowed under present law? Those commitments that occur in  
25 the law without the amendment to this package, or only the

1 credits that would be allowed as a result of this amendment?

2 Senator Bradley. I do not understand your question.

3 Mr. Brockway. Credits can be allowed for a number of  
4 taxpayers under current law. We are extending the period,  
5 that situation where you can have credit in the future, but  
6 some credits would be allowed in the future.

7 Would your limitation also apply to them?

8 Senator Bradley. Some credits allowed--

9 Mr. Brockway. For example, where a taxpayer has gone  
10 forward with a plan under current law--

11 Senator Bradley. That is Senator Chafee's question. This  
12 would deny them the tax credit.

13 The Chairman. Do you want a vote?

14 The Clerk will call the roll.

15 Mr. DeArment. Do I understand the energy tax credit to  
16 projects that receive synthetic fuel funds, loans, guarantees,  
17 price support, provided that there was not substantial invest-  
18 ment in the project in 1984?

19 Senator Bradley. That is right.

20 Mr. DeArment. Mr. Packwood.

21 Senator Packwood. No.

22 Mr. DeArment. Mr. Roth.

23 (No response.)

24 Mr. DeArment. Mr. Danforth.

25 (No response.)

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

1 (No response.)

2 Mr. DeArment. Mr. Bradley.

3 Senator Bradley. Aye.

4 Mr. DeArment. Mr. Mitchell.

5 (No response.)

6 Mr. DeArment. Mr. Pryor.

7 (No response.)

8 Mr. DeArment. Mr. Chairman.

9 The Chairman. No.

10 Senator Bradley. Mr. Moynihan, aye by proxy.

11 Senator Danforth. Danforth aye.

12 Senator Chafee. Does it apply to those companies which  
13 are already locked in or does it not? If they are locked in,  
14 does that hit them?

15 Senator Bradley. If the company has not made substantial  
16 investment in 1984, it hits them in '85, '86 and '87.

17 Senator Chafee. But if they have, it does not hit them?

18 I will vote aye.

19 The Chairman. That changes the vote from 10 to 4 to 9 to  
20 5.

21 There are nine nays and five yays, and absentees may be  
22 permitted to be recorded.

23 Are there any other questions about the total package?

24 Senator Long. The package you are talking about now is a  
25 reduction package, sounds like.

1           The Chairman. We are on the so-called add-ons. I asked  
2 Mr. Chapoton if he would go through and explain some of those  
3 he rejected. Senator Bradley had a question about one that he  
4 raised, and we have had that vote.

5           Buck, are you prepared?

6           Mr. Chapoton. Mr. Chairman, there is a long, long list.  
7 I was thinking if there were questions--

8           The Chairman. Do any members have any question about  
9 any provision that was not on the so-called add-on list?

10          Senator Matsunaga.

11          Senator Matsunaga. I have a very non-controversial one.  
12 It merely adds Virgin Islands and American Samoa to the list  
13 of territories, such as Puerto Rico and the District of  
14 Columbia, granting them the authority to issue private  
15 purpose revenue bonds. I believe, according to my note here,  
16 the Treasury has no objections to it.

17          Mr. Chapoton. I am not sure. We have traditionally  
18 objected, as you know, to broadening the list, broadening the  
19 issuance of private purpose bonds. That has been a concern  
20 of ours in the House bill. So we have had that concern  
21 about that. I am not certain where your information comes  
22 from.

23          Senator Matsunaga. As I understand it, you agreed,  
24 provided they come within sections of the Internal Revenue  
25 Code, Section 103, extended to D. C. and the possessions

1 under the House proposal. That is Section 103(b)(c)(h)(j)(k)  
2 and (l), and Section 103(a), and the proposal would bring  
3 these two jurisdictions under those sections.

4 Mr. Chapoton. I believe you are correct as long as they  
5 come under the restrictions on private purpose bonds presently  
6 in the Code that we have said that--while we are not excited  
7 about broadening the market--that it is not correct to allow  
8 these governmental entities not to have the same powers other  
9 governmental entities have.

10 Senator Matsunaga. I appreciate that because the  
11 American Samoa and Virgin Islands, being offshore communities,  
12 are at a great disadvantage vis-a-vis the mainland in regard  
13 to attracting business. I offer this amendment in behalf of  
14 Senator Moynihan and myself, if an amendment is necessary,  
15 Mr. Chairman.

16 Mr. Chapoton. Let me clarify.

17 I believe I said limitations presently in the Code. I  
18 would, of course, add any limitations that are adopted by  
19 this Congress or Committee, limitations on private purpose  
20 bonds generally.

21 Senator Matsunaga. So, Mr. Chairman, it is adopted then.

22 The Chairman. Could I make one observation? We were  
23 going over the energy tax yesterday and one hot button which  
24 caused some concern was the trust fund for the acid rain, and  
25 I have decided--we can approach that separately, and let us



1 just drop that from the proposal.

2 Then I would also indicate--Senator Baucus asked a  
3 question about No. 3 on the spending list. I have asked  
4 Sheila to go back and see if we can find the equivalent  
5 revenue some other way instead of cost restructuring.

6 Senator Baucus. I appreciate that, and also knocking  
7 out the trust fund.

8 Senator Long. I have a question along that line.

9 If you would restructure the big revenue raisers to  
10 raise more money on the energy tax and raise less on your  
11 income taxes, and I would suggest a way to raise less money  
12 on income taxes is to slide that 2 percent tax a little  
13 higher on the scale and not have the 5 percent. But basically  
14 a 2 percent tax on people that are doing pretty well. So  
15 you make your definition a little more meaningful, that you  
16 are taxing high income individuals and maybe ease up a little  
17 bit--maybe change a definition on economic income. I do not  
18 know what you are taxing there, but I think it will get us  
19 into controversial areas. So we are taxing economic income  
20 rather than taxable income. If you want to single out things  
21 that you want to tax as economic income, you might look at  
22 that individually, but if you make those modifications, I  
23 think it would be easier to vote for.

24 The Chairman. Obviously we can make adjustments. There  
25 is a great deal of flexibility. Some are opposed to the

1 energy tax. But, on the other hand, I think Senator Packwood  
2 and others suggested if we do anything, it ought to be on the  
3 consumption side. Senator Boren indicated strong reservations  
4 about the energy tax. What I would like to do is report out  
5 of this Committee this entire package sometime today. I am  
6 not suggesting we act on it before we leave here, but it  
7 would send a strong signal that the Finance Committee is  
8 still in there.

9 Senator Baucus. Mr. Chairman, I might add it would help  
10 several of us if we had some kind of chart that would give, to  
11 some degree, the distributive effects of the revenue provisions  
12 in particular. I know Senator Packwood has a certain philoso-  
13 phy in taxation, and I think distributive charts would help  
14 him where the taxes are going. It would help us this after-  
15 noon or maybe some other idea.

16 The Chairman. They may have some of that material.

17 Senator Baucus. That includes the energy provision as  
18 well because some States are hurt more than others. There may  
19 be ways to make adjustments after we see that.

20 The Chairman. Can you satisfy that?

21 Mr. Brockway. Yes, we can get back immediately to talk  
22 to Senator Baucus.

23 Senator Bradley. On another issue that is in the  
24 package that we were given under additional items, No. F,  
25 which is the allocation of research and experimental

1 expenditures, the proposal is to extend it for what period of  
2 time?

3 Mr. Brockway. It is a two-year extension.

4 Senator Bradley. Mr. Chairman, I would make the argu-  
5 ment that a two-year extension leaves a lot of these  
6 companies that are making major investments in research and  
7 development in a very uncertain state, and I think we ought to  
8 extend it to five years.

9 The Chairman. Let us do it.

10 Do you want to raise your other amendment?

11 Senator Bradley. It is on the spending side of the  
12 package. It is whether the medical intensive care unit will  
13 be covered under Part A of Medicare as opposed to Part B.

14 The Chairman. Are we prepared to take that up or should  
15 we wait until this afternoon? Why do we not touch upon that  
16 now because I think the Governor has been calling or is about  
17 to call.

18 While we are looking at your pages there, Senator  
19 Chafee?

20 Senator Chafee. Mr. Chairman, two things. On S, page  
21 6, the list of additional items, page 6, S, withholding tax  
22 on foreign portfolio investors. I think having the 3 percent  
23 in there just kills the purpose of it, and I would like to see  
24 that 3 percent removed.

25 Mr. Chapoton. As I said yesterday, Senator, we

1 originally proposed or supported legislation which would  
2 remove the tax. We have stuck with that position. So we  
3 would agree with you. If we would remove the tax altogether.

4 The Chairman. Does that make everybody on an even playing  
5 field?

6 Mr. Chapoton. It would make all such interest on port-  
7 folio debt exempt.

8 The Chairman. Dave, do you have a different view or did  
9 you reach the same conclusion?

10 Mr. Brockway. I think either way, whether you have a  
11 zero rate on bonds issued or 3 percent tax, that it would be  
12 equivalent, either way you could go, directly or through the  
13 Netherlands Antilles. The Antilles is concerned because they  
14 generate a certain amount of income. Going from zero to 3--it  
15 is just a question of whether you want to have a minimum tax  
16 on when foreigners invest in the United States. So that  
17 would pick up a little bit of the revenue by letting them  
18 invest tax free.

19 Senator Chafee. The question is trying to peddle the  
20 bonds and get as much income investment as possible. You are  
21 going to reduce the attractiveness of the investment, as has  
22 been shown by the fact that they have all used the lesser  
23 Antilles route to make the investment in the past and, there-  
24 fore, they were getting no withholding.

25 Now, if you put a 3 percent, they would not do it, or the

1 issuer will have to reduce what he is receiving.

2 Mr. Brockway. The idea is if you are trying to issue  
3 bonds in the United States, you have to pay tax. And if you  
4 issue bonds overseas where there is no information reporting  
5 to the holder, that they do not pay taxes in the foreign  
6 jurisdiction. So they have an ability to always underbid  
7 any U. S. bond issued in the United States because they do not  
8 have to pay taxes, and a bond buyer in the United States would  
9 have to. So the 3 percent is so low, 3 percent on the income.  
10 on the bond, you could still issue the bonds, again whether  
11 or not you go through the Antilles or directly, and there  
12 would be some pickup, minor tax pickup on the bond so that  
13 the foreigner investor would have to pay some amount of money  
14 to invest in a U.S. corporation. If you reduce the tax on  
15 any investors, whether U. S. investors or foreign, to the  
16 extent that you lower the tax, those people tend to be the  
17 ones buying bonds and you will push out of the market someone  
18 who is at a higher effective tax rate.

19 Senator Chafee. Well, what we are trying to do is  
20 encourage investment, and I think this does not achieve that  
21 goal.

22 I got one more, Mr. Chairman. I do not know how I made  
23 out on that one today. I have got Treasury which is a sub-  
24 stantial part of the struggle.

25

del 4

1 The Chairman. Was there a question?

2 Senator Chafee. The question was whether achieve suc-  
3 cess in removing the three percent.

4 The Chairman. I guess there is a split.

5 Senator Chafee. The weight of authority is on getting  
6 rid of it.

7 The Chairman. Where does that come from, Don Regan?

8 Senator Chafee. That came from Chapoton and me versus  
9 Brockway. I did not put you in the equation.

10 The Chairman. I do not understand this issue as well as  
11 Senator Chafee does. Let us think about that for another  
12 hour or two, because I do not think we are going to pass this  
13 whole package before noon.

14 Senator Chafee. Could I hear Treasury on S. 1750, which  
15 is double taxation on technical services, the engineering,  
16 architectural services in the U. S., that foreign jurisdiction  
17 tax?

18 We were hoping that that would no longer apply since, in  
19 order to encourage export -- export of the services -- you  
20 objected because of the reach of the foreign government.

21 Mr. Chapoton. The problem is there is a mismatch, and  
22 we maintain, and I think maintain correctly, based on principles  
23 of international taxation, that they are taxing U. S. force  
24 income.

25 So admittedly, if that happens, double taxation to that

1 extent will result. The solution proposed is that we give in,  
2 that the U. S. not tax that income, because they have reached  
3 -- while we are sympathetic, we think if we start down solu-  
4 tions like that, we are undermining the system of international  
5 taxation, and it is a very bad precedent. That is the main  
6 point. It is a very bad precedent.

7 Senator Chafee. It is a very unhappy situation in which  
8 the U. S. firms are losing out in a competitive race. You  
9 could say, if you give in to this, they will be reaching in and  
10 taxing the headquarters of the companies, or all of the act-  
11 ivities in downtown San Francisco.

12 But what we are trying to do is encourage exports, and  
13 particularly services, which is one of the factors that helps  
14 us in our balance of trade.

15 Mr. Chapoton. I do not want to overstate the case. I am  
16 not suggesting that it is going to mushroom, but it is a  
17 principle -- a mistake, quite clearly, on the other side. If  
18 we forgive the taxation to encourage the exports, then we are  
19 simply reducing our tax, because someone has chosen to tax  
20 this activity.

21 Senator Chafee. This does raise a little money. We just  
22 raised \$10 million.

23 Mr. Chapoton. I need to look at that again. I get the  
24 idea -- I will have to reexamine that.

25 Senator Packwood. Mr. Chairman, there is a provision in

1 Item C that slipped by. This educational employee assistance,  
2 the law presently provides if the employer provides educa-  
3 tional assistance for the employee, the value of the educa-  
4 tional assistance is not taxed as income. There is a non-  
5 discriminatory provision in there, so that you cannot send off  
6 the children of the boss to Harvard, and provide no educa-  
7 tional assistance to anybody else.

8 So there is no abuse. It is by and large used to train  
9 lower education people for better jobs in the company. The  
10 cost of that is significantly more than \$1,000 per employee  
11 per year, and I feel so strongly about this, that I simply  
12 cannot support this program if we put that cap in. We ought to  
13 extend this program two years. There is no allegation of  
14 abuse. It has the support of labor and unions. There is no  
15 need for the \$1,000 cap.

16 There has been no allegation of abuse, and with the non-  
17 discriminatory provisions, you cannot have an abuse.

18 Mr. Brockway. The provision in the package would put  
19 a \$1,000 cap on now, where you have employer-provided --

20 Senator Packwood. But you have not had allegations of  
21 any abuse. That is going to make it impossible for even tool  
22 and dye makers to train apprentices. We put in the non-  
23 discriminatory provisions in there to prevent saying we will  
24 pay for those who make \$50,000 in the company, and no one  
25 else.



1 Mr. Brockway. The cap does not apply where education is  
2 job related, for example, where your --

3 Senator Packwood. That is specifically what we got rid  
4 of. Damn it, I do not like this. We did not like it before.  
5 Treasury did not like it. You are trying to close what you  
6 think is a loophole, and it is unjustified. Two years ago you  
7 had to make a distinction between a job related training and  
8 one that advanced you for a better job.

9 So if you were a low level high school dropout, and were  
10 going to work as a tool maker, that was okay. But if you have  
11 a vice president, they would sent you over to Brookings  
12 Institute at \$1,000 a day, and that was not income, and we  
13 put in the provisions, and I object to the staff trying to undo  
14 what we did two years ago, and I am not going to support this  
15 if it is in here.

16 The Chairman. Do you have anything to say?

17 Mr. Rollyson. Senator, I do not have the background of  
18 two years ago. I can tell you, we have suffered from two  
19 things. One, we have no information reporting requirements.

20 Senator Packwood. You have not got a damn instance of,  
21 or allegation of abuse. You have auditing procedures that  
22 you can look at. You are asking employers to file a bunch of  
23 forms that will deter them from giving this educational pro-  
24 gram to low and middle income employees. The higher income  
25 do not need this as much, because it is allegedly related

1 to the higher income jobs.

2 We are cutting out money for vocational education, and  
3 everything else, and you are trying to foul this up. Mr.  
4 Chairman, I am going to move to strike out the \$1,000 cap,  
5 and the reporting requirements. There has been no evidence  
6 that anybody needs this.

7 Mr. Brockway. Senator Packwood would like also the  
8 reporting requirements stricken, as well as the \$1,000  
9 limitation.

10 Senator Packwood. No allegations of any abuse by anyone,  
11 not Treasury, not IRS.

12 The Chairman. Does IRS or Treasury have anything to say?

13 Senator Packwood. The allegations of abuse were before  
14 we passed the nondiscriminatory provisions, and you could use  
15 the program to educate at a very expensive educational insti-  
16 tution the sons and daughters of the executives. That part we  
17 eliminated, and that was a good elimination.

18 Mr. Rollyson. One of our problems is we do not have any  
19 information reports, and it is for that reason we cannot be  
20 asked to be specific in response to the Senator's comments.  
21 But we hope you would consider some kind of reporting, so that  
22 we will have the data.

23 Senator Packwood. You have the right to audit. You do  
24 not need the information. You do not have an allegation of  
25 abuse. You are going on a witch hunt, for something that does

1 not exist.

2 Senator Bentsen. Mr. Chairman, I had to step out of the  
3 room.

4 Would you advise me, Senator Chafee and I had this pro-  
5 vision on withholding tax and foreign investments.

6 The Chairman. I suggested that we might take care of it  
7 after lunch. We will come back about two.

8 Senator Grassley. Did we make an agreement yesterday that  
9 we would take care of agriculture on this prepayment situation?

10 Mr. Brockway. Yes, we have something where it is a  
11 family farm, that they would have an extended period where  
12 they have to acquire fertilizer, and that type of thing, but  
13 not the tax shelter.

14 Senator Grassley. Not only from the extent of time, but  
15 from the standpoint of what that segment of the economy -- I  
16 think there should be no change. That is what I would like to  
17 argue, that there be no change in the normal pattern in which  
18 the farmer has done business in this area of prepayment.

19 Now, if there is some sort of person not involved in  
20 agriculture, that is using it for a big loophole, that is  
21 probably detrimental to agriculture, I agree. But I do not  
22 want to be doing something that will force agriculture into  
23 the accrual method of agriculture.

24 Senator Pryor. If I could add something to Senator  
25 Grassley's comments, and I strongly support what he is doing,

1 I would like to take issue with Treasury, because this does  
2 not just apply to family farms. It goes wider than that. I  
3 think this provision is very dangerous, and I think we ought  
4 to be very cautious.

5 Senator Grassley. If we are not going to be able to work  
6 this out so we can preserve the status, go as far as what we  
7 recognize as the family farm, then I want to strike this  
8 whole provision.

9 Mr. Brockway. We have a provision that we can go over  
10 with you.

11 Senator Symms. If Treasury is trying to get small  
12 business out of a cash reporting system -- we ought to strike  
13 it out of there.

14 Senator Grassley. It is going to have that result.

15 Mr. Chapoton. That is not the intent. If it has that  
16 impact, we should address it accordingly. The intent is to  
17 catch the situation -- the tax shelter arrangement where people  
18 make payments far in advance to shelter income with the idea  
19 that you pay it now, and get a large tax advantage.

20 Senator Symms. What about a packinghouse?

21 The Chairman. What about Frank Perdue, that chicken man?

22 Mr. Chapoton. Mr. Perdue would be taken care of in the  
23 same way that Senator Grassley is talking about.

24 Senator Symms. Let us say a commercial packinghouse, that  
25 packs potatoes, and they think they are making a good year,

1 so they go ahead and buy a lot of supplies for next year.

2 Mr. Chapoton. General supplies for the next year will  
3 not be affected. General business practices will not be  
4 affected. That all can be clarified. The cases we are con-  
5 cerned about is where there is a large payment at yearend, or  
6 activity that is not anticipated for a substantial period of  
7 time.

8 The Chairman. Let us try and work on that. We are going  
9 to be in recess until two o'clock, and Senator Packwood, I  
10 think, has made himself fairly clear on one issue, and we will  
11 work on that, and we will work on Senator Grassley's concern,  
12 and give us some time to work on the foundations.

13 Mr. Brockway. We are also working on the charitable item  
14 for Senator Moynihan.

15 The Chairman. Restructuring, Shiela. I do believe I  
16 sense a lot of movement in support of the package, so I hope  
17 by the time we finish tonight, we can express in this Committee  
18 our strong desire to face up to the deficit.

19 Also, Rod, will you -- Senator Long had some ideas, and  
20 some of the major items in the package that we should address.  
21 Restructuring the Medicare I think is a matter of concern for  
22 a number of Senators.

23 Other than that, I am certain there are other problems  
24 that might be raised.

25 Senator Pryor. Mr. Chairman, I would like to raise one

1 question, and I know we are about to quit, in three areas, the  
2 energy tax, the surtax, the corporate tax, which would be  
3 about \$40 billion, as I understand it, over four years, if  
4 these taxes prevail, and they would be new taxes, and they  
5 would be easily identifiable.

6 If they do prevail in this Committee, I will, upon their  
7 prevailing, attempt to try to earmark these new revenues into  
8 deficit reduction fund, which would be a trust fund -- we are  
9 already creating one in here, the acid rain fund --

10 The Chairman. We took that out.

11 Senator Pryor. But I do want you to know, and I may pro-  
12 pose that should these new revenues prevail.

13 The chairman. Why do we not make it a part of the pack-  
14 age? Then you can vote for the total package.

15 Senator Pryor. There is a possibility I can vote for  
16 the total package, but I do not think I can vote for it unless  
17 this money is earmarked and untouchable in the area of general  
18 revenues.

19 The Chairman. That is the same concern the President has  
20 expressed, if we raise money, we will spend it.

21 Senator Pryor. I have that same concern. Knowing us as  
22 well as I do.

23 The Chairman. Two o'clock.

24 [Whereupon, at 12:15 p.m., the Committee recessed, to  
25 reconvene at 2:00 p.m., the same day.]

1           The Chairman. Let me say first of all that there may be  
2 some Finance Committee amendments offered to the supplemental  
3 bill which might require that this meeting not last as long as  
4 we had hoped because there is talk of Social Security  
5 amendments, disability amendments, mortgage bonds, and a few  
6 other areas.

7           I think the leadership has indicated they will table all  
8 amendments to this bill, but in any event we will probably have  
9 to make the case.

10          Let us see. Senator Moynihan, did you have a question  
11 on IDBs that you wanted to raise with Mr. Chapoton?

12          Senator Moynihan. Yes, Mr. Chairman. Those projects  
13 which, because they were underway in some substantial way,  
14 in the reconciliation bill we exempted them from the new  
15 prohibition on sale-lease back of publicly owned properties.

16          It appears that those sale and lease back arrangements  
17 assumed the previous IDB depreciation schedules, and we would  
18 wonder if it were not possible for those projects to retain the  
19 old schedules as we move to the new ones for new projects.

20          Mr. Chapoton. Senator, we talked about this. Mr.  
21 Chairman, the logic is that these projects were exempted and  
22 retained faster depreciation under the leasing to tax exempt  
23 rules, and that therefore it would be illogical to go back and  
24 pick them up under the general IDB rules. I can certainly see  
25 the logic in that.

1 I wanted to compare the difference in depreciation rates  
2 under the two schedules.

3 Senator Moynihan. Fine, if that could be done. I think  
4 Senator Heinz has --

5 The Chairman. Senator Heinz?

6 Senator Heinz. Mr. Chairman, I would hope that the  
7 arrangement that we worked out on projects that are in the  
8 process of coming under construction would not be disrupted  
9 by the IDB restrictions.

10 I know it affects Senator Moynihan. It affects  
11 Philadelphia, and I want to apologize to my colleagues. I was  
12 otherwise engaged and I do not know if anyone mentioned solid  
13 waste as something that might be temporarily grandfathered,  
14 too.

15 The Chairman. I assume if we can agree to that, we need  
16 to do it on reconciliation.

17 Senator Moynihan. I believe so.

18 Mr. Chapoton. Well, no. It is only affected by what  
19 you are doing today.

20 The Chairman. Oh, I see.

21 Mr. Chapoton. It is okay under the leasing because it  
22 is a transitional ruling.

23 Senator Heinz. What Senator Moynihan and I are saying is  
24 that, assuming we would go ahead with this, we would protect  
25 them here.



1            Senator Moynihan. Well, I do not want to be tedious, but  
 2 if these contracts are going to be signed, they do not want to  
 3 have this prospect unsettled. I think it has to be done under  
 4 reconciliation.

5            Mr. DeArment. As long as we provided for it in this  
 6 bill, because this is the bill that we are working with right  
 7 now that has the IDB restrictions in it -- as long as they  
 8 were grandfathered from the restrictions that we proposed in  
 9 this bill, whether they should ever become law or not, then  
 10 they could get --

11            Senator Moynihan. Well, if that could be done, we would  
 12 very much appreciate it.

13            Senator Durenberger. Mr. Chairman?

14            The Chairman. Senator Durenberger?

15            Senator Durenberger. I have two or three items: one an  
 16 amendment on behalf of my colleague from Minnesota which would  
 17 allow continued cash rental of property to family members  
 18 after a decedent's death, and it is a continued qualification  
 19 under special use provisions of the code.

20            Prior to ERDA, the IRS had taken the position that cash  
 21 renting farms disqualified the farm from special use  
 22 valuation because the decedent had not been actively  
 23 participating in farming the land.

24            The IRS then took ERDA revisions to mean that only the  
 25 decedent may cash rent the farm and still have the land.

1 qualify for special use valuation. Therefore, if the family  
2 continues to cash rent the farm after the decedent's death,  
3 the recapture provisions will kick in and the IRS recaptures  
4 the tax savings because of the special use valuation.

5 This amendment would allow widows, heirs over age 65,  
6 disabled heirs and heirs under the age of 21 or students to  
7 continue to cash rent a farm and be eligible for special use  
8 valuation.

9 I do not know if someone has had a chance to look at this  
10 in advance.

11 Mr. Chapoton. I remember we dealt with the cash rental  
12 problem, I think, in ERDA. Maybe we dealt with it in the case  
13 of the decedent and not in the case of the heirs is what it  
14 sounds like, so let us look at that.

15 The Chairman. Do you have a copy of that?

16 Senator Durenberger. Yes. I can just hand it to somebody  
17 right here.

18 The second one that I hoped we have looked at is the  
19 amendment relative to the elimination of compensation treat-  
20 ment for the grants that are made pursuant to the Boundary  
21 Waters Canoe Area Act of 1978.

22 Part of that Act, which was bloody politics around here,  
23 was a provision that would compensate certain small businesses  
24 for direct economic losses when the law changed a lot of the  
25 private uses by way of changing the public uses of property.

1           The Internal Revenue Service has taken the position  
2 recently that they want to tax these particular payments as  
3 compensation, which they were never intended to be. The  
4 dollar amounts are not very large.

5           The problem here is all these people had an option to let  
6 their property be condemned as an alternative. They took  
7 this option, believing that the compensation would be tax-free.

8           Mr. Chapoton. Well, Senator, I was going to suggest it  
9 sounds close to condemnation, and condemnation does receive  
10 favorable treatment if the funds are reinvested. I do not see  
11 how you could provide better treatment than condemnation, but  
12 it does seem to me that there might be some logic. I did look  
13 at it earlier and that was how it appeared to me, but it would  
14 require reinvestment of the funds.

15           Mr. DeArment. As I understand it, these funds were  
16 going to allow these outfitters to transition into a non-  
17 motorized way of operation in many cases.

18           Senator Durenberger. Yes. It was principally designed  
19 as a reinvestment, as I recall.

20           Mr. DeArment. Presumably, they would be reinvested.

21           Mr. Chapoton. I think that would make some sense.

22           Senator Durenberger. The next one, Mr. Chairman, is the  
23 terminal rental adjustment clause, and I take you to Section  
24 210 of TEFRA, which I understand the Treasury has tried to  
25 undo with an interpretive ruling.

1 My amendment, in effect, would restate the provisions of  
 2 Section 210 regarding motor vehicle operating leases. I will  
 3 just read very briefly: "In the case of any qualified motor  
 4 vehicle agreement, the fact that such agreement contains a  
 5 terminal rental adjustment clause shall not be taken into  
 6 account in determining whether such agreement is a lease."

7 Just by way of explanation, the term "terminal rental  
 8 adjustment clause," as in the law currently, means the  
 9 provision of an agreement which permits or requires the rental  
 10 price to be adjusted upward or downward by reference to the  
 11 amount realized by the lessor under the agreement upon sale or  
 12 other disposition of property.

13 And I think as everyone knows, for 25, 30 years it has  
 14 been the practice, particularly in the automobile leasing  
 15 business, to have something like a track clause at the end of  
 16 an agreement in which the lessor would sell the vehicle on the  
 17 open market.

18 And if the price was higher than the price in the track  
 19 clause, then there would be a rebate to the seller; otherwise,  
 20 it would be vice versa. All this is intended to do is restate  
 21 what we thought was the law in 1982.

22 It does not compel Treasury for tax purposes to treat  
 23 these agreements as a lease. It only says that you cannot  
 24 consider the track clause as making it a lease for tax purposes.

25 Mr. Chapoton. But, Senator, the track clause is the

1 controlling event. Let me retrace that just a bit. The track  
2 clause has the effect of transferring the risk of ownership  
3 to the lessee. I think almost everyone who reviews the  
4 arrangement would have to agree on that, as did the Ninth  
5 Circuit when the case was considered by the Ninth Circuit.

6 So we are faced with a case where the substance of the  
7 arrangement is such that the lessee has the burden. It is  
8 treated as though it is not a lease, but a conditional sale.  
9 When the question came up during ERDA or TEFRA -- I forget  
10 which -- it was argued that this had been the practice in the  
11 automobile industry for a number of years.

12 The law said that that will not be changed until Treasury  
13 issues regulations stating otherwise, and we did. I think  
14 no one should have been surprised in the way the statute was  
15 drafted.

16 We did issue a proposed set of regulations stating  
17 otherwise; that is, that the track clause would cause the  
18 leases to be considered conditional sales and not leases.

19 If we go the other way, if we now put permanently in the  
20 law -- and I think it ought to be a permanent provision in the  
21 law and not thrust back on us because what we are really  
22 saying is that if you have a track clause or any other clause,  
23 for that matter, that results in the risk of ownership being  
24 thrust on the lessee, we will not consider it a lease, not-  
25 withstanding that clause.

1           Once we say that, what we have said to the people -- and  
 2 I have with a lot of people on this very question -- is how do  
 3 you distinguish automobiles from other equipment? And indeed  
 4 I think in at least one of the bills that we have considered,  
 5 it does just what you would expect.

6           It extends it to the next item; it extends it to farm  
 7 equipment or to -- there is no reason not to extend it to  
 8 computers or to any other equipment. The question is whether  
 9 the clause has the effect of transferring economic risk to  
 10 the lessee, and therefore would not be a lease if you take  
 11 that clause into account.

12           The Chairman. Does Treasury then object?

13           Mr. Chapoton. Yes, sir, we do object.

14           Mr. Brockway. It is correct that the legislation last  
 15 year did not change the substantive law in the area. It just  
 16 said that Treasury could not apply any rules retroactively,  
 17 and said that in the future Treasury could write regs in the  
 18 area, and that is what they did after the legislation.

19           Last year's legislation was not legislation that said  
 20 in the future a track lease would be treated as a lease.

21           Senator Durenberger. Well, I think the anticipation was  
 22 that at least some of the things that Buck has said, relative  
 23 to the problems were going to be the matter of some  
 24 investigation or some study or something. And I think what  
 25 happened was that, according to the ruling, you made an

1 assumption that has created a substantial problem in the  
2 industry.

3 Mr. Chapoton. But the regulations are proposed and  
4 nobody is affected until those regulations are final under  
5 that law. Now, we have had meetings. We have asked for  
6 different analyses.

7 I think the main argument that we receive is that why  
8 should one care as long as the business lessee is a business  
9 user because he would be entitled to the investment tax credit.  
10 It should be a wash, and in many cases it will indeed be a  
11 wash. In many cases it will not be a wash.

12 It is the old leasing problem again and the question of  
13 who is the economic owner of the property.

14 Senator Durenberger. Can anybody tell me how we got the  
15 estimate of the revenue increase over some substantial period  
16 of time to the Treasury?

17 Mr. Brockway. Well, the assumption is that you have got  
18 in this situation a possibility that what would happen if they  
19 are treated as conditional sales rather than leases is that  
20 they would use the 483 deferred payment rules to overstate the  
21 value of the vehicle, understate the interest charge, and  
22 then have a higher basis for investment credit, using those  
23 rules.

24 It partly depends upon whether the users of the auto-  
25 mobiles are personal users or business users. If it is a

1 business user, then either way there would be an investment  
2 credit and depreciation. It would just depend upon who was  
3 in a taxable position. It would be a wash if both of them  
4 were taxable entities.

5 If it is a personal user, then there would be no invest-  
6 ment credit under a conditional sale. However, the individual  
7 user would have an interest deduction, and this is just the  
8 way in this five-year period the numbers washed. How it  
9 would be on a long-term basis, I do not know, but we would not  
10 expect it, in the auto area, to be substantial.

11 The Chairman. Well, let us --

12 Senator Durenberger. Well, I intend to move this as an  
13 amendment at some appropriate time.

14 The Chairman. Okay. Well, did you have any others to  
15 raise? Senator Heinz wanted to raise just one issue that we  
16 have discussed.

17 Senator Durenberger. Well, I do have the ethanol fuels  
18 that might take a little bit -- I would be glad to raise it  
19 right now.

20 The Chairman. Why do we not raise that when we come  
21 back?

22 Senator Durenberger. All right.

23 The Chairman. We will let Senator Heinz raise one that  
24 we have raised earlier, and I think staff is trying to work  
25 out something on it now.



1 Senator Heinz. Mr. Chairman, I would hope we could act  
2 on the coal gasification amendment to 1564. I think the staff  
3 is familiar with the situation. This amendment is quite  
4 important in Illinois and, I know, to Senator Percy.

5 I guess the problem just briefly is that the Wood River  
6 coal gasification plant is about half completed. It is funded  
7 by two private sources and the state of Illinois. The state  
8 built and financed in reliance upon the ability to utilize  
9 safe harbor leasing.

10 The proposed amendment, which is identical to S. 1437  
11 introduced by Senators Percy and Dixon, would include coal  
12 gasification facilities placed in service before January 1st,  
13 1984 in the transitional safe harbor lease property category  
14 defined in Section 28(d)(3) of TEFRA.

15 The Chairman. I am familiar with that. In fact, we have  
16 met with some of the Alice Chalmers people. It is my  
17 understanding that your staff is now in the process of trying  
18 to figure out some way to accommodate at least a portion of  
19 their concern based on what we may have done in other areas  
20 without breaking new ground. Is that correct?

21 Mr. LeDuc. We are underway on that, Mr. Chairman. We  
22 have been advised by the affected taxpayer that they have  
23 already claimed significant tax benefits from this project in  
24 construction and that, accordingly, there will be some  
25 recapture; that is, some adverse tax consequences from a safe

1 harbor lease.

2 We are continuing to talk with them to see if, pursuant  
3 to your suggestion, we can come up with an amendment which  
4 provides some relief but does not take care of the entire  
5 plant.

6 Senator Heinz. Well, I hope, Mr. Chairman, we can do  
7 something in this regard.

8 The Chairman. Well, I have indicated to Senator Percy  
9 that if it were consistent with past actions, we would want  
10 to be helpful. So you are continuing to pursue that, I  
11 assume.

12 Mr. LeDuc. We are, Mr. Chairman.

13 The Chairman. I think we have about five minutes left on  
14 the vote. Senator Packwood will be right back and he has a  
15 couple of matters of his own to take up, so we can do that.  
16 And I think Senator Symms had something he wanted to bring up.  
17 I am certain there are other Senators who may think of  
18 something while they are voting.

19 (Whereupon, a brief recess was taken.)

20 Senator Packwood. Buck, let me ask you a question, or  
21 the joint staff. On the additional items is item EE, excep-  
22 tion to debt-financed property rules. As I understand it, we  
23 have agreed to extend the present exception which applies to  
24 pensions to colleges. Is that correct?

25 Mr. Chapoton. Yes, that is correct.

1 Senator Packwood. As I recall, Treasury's great objec-  
2 tion was to the debt financing provision of this, but you are  
3 willing to extend it to the colleges, and that is what we are  
4 doing.

5 Mr. Chapoton. I am sorry. We did not like extension  
6 of exception of the debt-financed rule.

7 Senator Packwood. Well, you never liked any of it. You  
8 do not like it for pensions either, if you had your druthers.

9 Mr. Chapoton. That is correct.

10 Senator Packwood. But as long as we are extending it to  
11 colleges, so long as it is limited to that, there are two  
12 additional provisions to which you do not have serious  
13 objection.

14 One is allowing non-profit organizations, assuming they  
15 fit in this, to be able to pool their ownership rather than  
16 requiring that only one entity is the owner.

17 Mr. Chapoton. That is right, as long as they are all  
18 tax-exempt.

19 Senator Packwood. Yes, as long as they all fit the  
20 exemption.

21 Mr. Chapoton. Right.

22 Senator Packwood. And, two, you have no serious  
23 objection to a real estate packager putting these organizations  
24 together for the non-profit organization, so long as all of  
25 the participants are tax-exempt?

1 Mr. Chapoton. And everything is at arm's length so that  
2 there would not be any passing --

3 Senator Packwood. Oh, yes. Good, if the staff would  
4 make sure those two provisions are in.

5 Then I had two other questions.

6 Mr. Chapoton. Senator, we are talking about educational  
7 or pension organizations?

8 Senator Packwood. Yes. A packager could package those  
9 kinds of organizations so long as the participants in them  
10 fit into those two categories, the pensions or the  
11 educational institutions, as we are defining them.

12 Mr. Brockway. That is the structure of the item E.

13 Senator Packwood. Yes. I am amending Sparky's proposal  
14 very slightly.

15 Next, I am curious about -- under the item called Summary  
16 of Proposed Deficit Reduction Packages --

17 Mr. Chapoton. Senator, could I add one more thing on  
18 the thing we just discussed?

19 Senator Packwood. Yes.

20 Mr. Chapoton. In our testimony we had proposed making  
21 clear there was separation between the real estate developer,  
22 the fellow who put together the package, and the charity. We  
23 suggested there should not be a connection. He should not  
24 have a fiduciary responsibility or relationship to the tax-  
25 exempt --

1 Senator Packwood. No. He is a genuine packager that  
2 goes out and says to nine different colleges, "I can put  
3 together this combination of buildings for you and manage it  
4 so long as everybody that participates in it is an exempt  
5 institution."

6 Under accounting abuses, 4, related party transactions,  
7 since this sheet has come out, I have had numerous complaints  
8 from Oregon and elsewhere that this is going to do damage to  
9 the packages put together for low-income housing. Can you  
10 explain to me whether it does or not because I do not think  
11 any of us intended to injure the low-income housing that has  
12 been packaged by real estate promoters?

13 Mr. Chapoton. Well, Senator, I think that some low-  
14 income housing deals are packaged where a principle will sell  
15 property to a partnership and then play this game of setting  
16 it up so the partnership is on the accrual basis and takes  
17 deductions now. And he is a small partner, maybe a one  
18 percent partner, and will not pick up any income for 20 or 30  
19 years.

20 And to the extent that happens in low-income housing or  
21 any other arrangement, we think that is a serious mismatching.

22 Senator Packwood. Run that by me again because I want to  
23 make sure we are not doing any violence -- we have cut back  
24 far enough on low-income housing, but I want to make sure we  
25 are not doing any violence to the existing packaging of

1 low-income housing with this provision.

2 Mr. Chapoton. Well, the transaction that would be caught  
3 and is intended to be caught, and is sometimes used in low-  
4 income housing, I am told, is where the promoter, let us call  
5 him, puts together the deal, sells it to a partnership --

6 Senator Packwood. Promoter Jones puts it together and  
7 says to a hundred partners, "You each put up \$10,000 and we  
8 are going to build 200 low-income houses."

9 Mr. Chapoton. It would be an "in existence" case. He  
10 would buy an existing low-income housing project.

11 Senator Packwood. All right, they buy it. Now, what  
12 happens?

13 Mr. Chapoton. They buy it and the partnership is put on  
14 the accrual basis, gives promoter Jones a note and that note  
15 bears interest at a reasonable rate -- 12, 15 percent,  
16 whatever.

17 And the note provisions are no interest payment for a  
18 number of years, maybe until the end of the note. But the  
19 partnership, because it is on the accrual basis, takes no  
20 deductions currently. On the other side of the transaction,  
21 Jones picks up no income until the end of the note, and that  
22 mismatching is exactly what this is aimed at.

23 Senator Packwood. Are we trying to get at the partners  
24 or are we trying to get at Jones?

25 Mr. Chapoton. Well, we do not care as long as they treat

1 it the same. It would disallow it until he picked it up.

2 Senator Packwood. In other words, it would disallow the  
3 accrual to them until he picks up the income?

4 Mr. Chapoton. That is correct.

5 Senator Packwood. Or they could have the accrual now if  
6 he takes the income now?

7 Mr. Chapoton. That is correct.

8 Senator Packwood. Okay. I do not want to sign off on  
9 that. I want to do some further checking.

10 Is this going to have the effect of significantly  
11 reducing the number of these packages that put together and  
12 make available low-income housing?

13 Mr. Chapoton. It should not have any effect on new  
14 construction; it may on some of the others. Yes, it could  
15 have. But more than likely, it would be existing deals. It  
16 would change the economics of selling old, existing low-income  
17 housing.

18 Senator Packwood. Well, we use the tax code justifiably  
19 for all kinds of incentives and, on occasion, people make  
20 good money out of it because they invest in things that we say  
21 are socially worthwhile. Sometimes, we cannot have it both  
22 ways.

23 Mr. Chapoton. But, Senator, this was not a designed  
24 benefit. There are significant benefits in real estate, in  
25 general, and more significant in low-income housing. The

1 depreciation benefits are dramatic.

2 This was never a designed incentive for real estate or  
3 for low-income housing. It is clearly taking advantage of I  
4 would just call it a loophole in the code where you have mis-  
5 matching of the income and the deduction.

6 Mr. Brockway. Senator, this is not the basic incentives  
7 that you put in the code for more rapid depreciation for low-  
8 income housing and an exemption from construction period  
9 interest and taxes -- that type of transaction.

10 Once you have gone through the full cycle and received  
11 the first tax incentives and the partnership wants to sell it  
12 over to the partner on that transaction, where you will have  
13 a note between the first partnership and the second partner-  
14 ship, at that point the promoter might take the property with  
15 a debt.

16 He would not take into income and they would deduct the  
17 interest. It is an advantage on the turnover of the property.

18 Senator Packwood. Let me tell you the reason I ask this.  
19 Every now and then we do things in this Committee  
20 unintentionally that cause grievous harm, and sometimes we  
21 do not think it is grievous harm, but the people affected do,  
22 and we did it unintentionally, the biggest one being carryover  
23 bases. I remember how we adopted it, not knowing what it did.

24 I just want to make sure that if we adopt this -- and I  
25 understand what Buck is talking about in terms of technical



1 tax policy. It may be good policy, but I want to make sure  
2 that in closing this loophole, if it is a loophole, we are  
3 not unintentionally significantly reducing the amount of low-  
4 income housing that is available. It is low enough as it is.

5 I do not sense anybody knows how much we might be  
6 affecting that.

7 Mr. Chapoton. No. In all candor, though, it is very  
8 difficult. I think it more than likely will change the  
9 economics of the sale of existing low-income housing rather  
10 than --

11 Senator Packwood. My hunch is if this works as you hope,  
12 it will not catch the sheltered income. It will go off into  
13 some other incentive where they will find an equally good way  
14 to shelter it, but it will not be low-income housing.

15 Mr. Chapoton. Well, this is not limited to low-income  
16 housing by any means. This is a popular taking advantage of  
17 a mismatching available in the code. Generally, the rules in  
18 the code do not allow this, but because a partner and the  
19 partnership are not considered related parties for this  
20 provision of the code, people have awakened to that fact and  
21 have designed a transaction around it.

22 Senator Bentsen. At some point, could I get into this  
23 educational process?

24 Senator Packwood. Yes. I would appreciate it.

25 Senator Bentsen. It goes beyond low-income housing, just

1 as the Secretary is stating. When you are talking about the  
2 division of the accrued expenses between related parties, I  
3 certainly agree there has to be some limitation placed on it.  
4 There have been substantial abuses.

5 My only concern is, once again, in correcting whether we  
6 are overreaching or not. As I understand it, a person could  
7 have as little as a one percent interest and you would have  
8 this kind of an application applied to them.

9 That seems to me quite far-reaching and I am wondering if  
10 something on the order of a ten percent limitation might not  
11 be more appropriate.

12 Mr. Chapoton. Senator, we looked at that. When you look  
13 at the transaction more closely, the percentage interest in  
14 the partnership is really not relevant. The question is that  
15 he is the party that sold the property; he is a player in the  
16 transaction as represented by the fact that he has some  
17 interest in the partnership.

18 The mismatching occurs really without regard to the  
19 magnitude of his interest in the partnership. If I am a one  
20 percent partner and I am selling, a part of what I am selling  
21 is the current deduction and I am willing to sell it because  
22 I am not going to pick up the income for a number of years.

23 Yet, I am remaining a partner in the buying partnership.

24 Senator Bentsen. Well, I would have some concern in  
25 stretching it that far and I would like to look into it again.

1            Senator Packwood. I think I would like to wait for a  
2 couple of more members to see if they have the same complaints  
3 I do. Buck, I do not want to keep any more loopholes than we  
4 need if we do not need them, but I am going to be mad if we  
5 lose 5 or 10 or 15,000 units of low-income housing that we did  
6 not know about.

7            That is all the questions I have right now. Lloyd, do  
8 you have any?

9            Senator Bentsen. No.

10           Senator Packwood. Bill?

11           Senator Roth. No.

12           Mr. Chapoton. Senator, we were talking to the staff.  
13 The case that I described and I think you were talking to was  
14 the partner selling to the partnership. Where there are two  
15 partnerships, we agree that there ought to be a de minimis  
16 rule making sure they are related parties.

17           If that is the case you are talking about, then we have  
18 no problem with the two partnerships.

19           Senator Packwood. Now, explain that to me.

20           Mr. Chapoton. That is where one partnership sells to  
21 another partnership, and the question you are then testing is  
22 whether they are related to each other. They are related if  
23 there is common ownership, and there ought to be a de minimis  
24 rule before you say they are related.

25           For example, a partner has to own "x" percent -- five

1 percent, ten percent -- in each partnership before you would  
2 consider the two partnerships related.

3 Senator Packwood. Well, now, are you suggesting making  
4 some slight amendment to this provision?

5 Mr. Chapoton. No.

6 Mr. Belas. That is how it was drafted.

7 Mr. Brockway. Yes. In the drafting, what we had done  
8 is where the partnership -- there was less than a five percent  
9 in the pay partnership and the rule would not apply at all,  
10 and between 5 and 50 percent it would only be pro rata.

11 So, if it was a ten percent in the pay partnership and  
12 accrual from one partnership to another, then in that situation  
13 where there is only a ten percent interest in the pay  
14 partnership, you would only have this rule apply to defer the  
15 deduction on ten percent on the amount of the accrual.

16 Over 50 percent, then it would trigger in a full  
17 accrual -- defer the entire accrual that they will pay. But  
18 that is the way it was drafted. That is not the way the  
19 House bill is. The House bill does not have that type of  
20 de minimis rule.

21 Senator Packwood. Well, I appreciate your making it  
22 clear.

23 We will wait until other members come.

24 (Pause.)

25 Senator Packwood. We went over low-income housing and I

1 heard the explanation. I am not sure I understand it.

2 The Chairman. Who gave the explanation?

3 Senator Packwood. Well, it was kind of collective.

4 The Chairman. Now, I wanted to continue to do -- I think  
5 Senator Symms and Senator Boren wanted to raise something.  
6 Do you have anything else, Lloyd?

7 Senator Bentsen. No.

8 Mr. DeArment. There was a question raised, Mr. Chairman,  
9 about item E and the additional items which deal with  
10 supplemental security income. Senator Long had raised a  
11 question about rather than making it permanent, which we  
12 proposed here, to extend it for three years.

13 Senator Packwood. Excuse me. Which chart is this?

14 Mr. DeArment. This is in the additional items.

15 Senator Packwood. I have got four items. Which item  
16 within that is it?

17 Mr. DeArment. Item E on page two.

18 Senator Packwood. Supplemental security income?

19 Mr. DeArment. That is correct. It is section 619 of  
20 the Social Security Act which lets disabled people work and  
21 continue to get Medicaid and SSI benefits.

22 The Chairman. And the suggestion is to extend it for  
23 three years?

24 Mr. DeArment. Three years.

25 The Chairman. I think that may be a good idea.

1           While we are waiting for other members to come, any staff  
2 areas that you want to discuss now, Dave?

3           Mr. Brockway. Well, we could --

4           The Chairman. Have you got the foundation thing worked  
5 out, for example?

6           Mr. Brockway. Well, I do not know whether the entire  
7 package is assembled, but they are working on that. Senator  
8 Long had suggested maybe changing the rates on the package,  
9 increasing the energy tax some and moving things around.

10          The Chairman. Why do you not discuss the suggested  
11 changes? I think they were in the surtax areas and in the  
12 corporate surcharge, and then I guess a slight change in the  
13 energy tax.

14          Mr. Brockway. Yes. The suggestion was to raise the tax  
15 in the package. As you originally had presented it, it was a  
16 two percent energy tax and a two percent corporate surtax and  
17 an individual surtax of two percent over \$6,300 of tax and  
18 five percent over \$22,000.

19          As a result of Senator Long's suggestion, we went back  
20 and looked at a package that would put all these at 2.5  
21 percent -- have an energy tax at 2.5 percent, have a corporate  
22 surtax at 2.5 percent, and have the individual surtax at 2.5  
23 percent, and rather having that kick in at \$45,000 of adjusted  
24 gross income, have the individual surtax kick in at about  
25 \$75,000 of income. So it would only hit the tax that you

1 would have to pay at \$75,000.

2 One other change would be to increase the zero bracket  
3 amount back up, instead of \$100 on a single and \$200 on a  
4 joint, increasing it to \$200 on a single and \$400 on a joint.  
5 In the aggregate, that would reduce the revenue, I think,  
6 roughly about \$3 billion. We are looking at that.

7 The reason for making the change and increasing the zero  
8 bracket amount is just because you are increasing the energy  
9 tax and trying to still keep an overall even distribution of  
10 the burden.

11 The Chairman. Right, and that adjustment in the zero  
12 bracket would add about 3 billion?

13 Mr. Brockway. That would cost you about \$3 billion.

14 Mr. DeArment. It would not be adjusted. It would be in  
15 two steps; first, 100 to 200, and then 200 to 400.

16 Mr. Brockway. Exactly, the same way as in the original  
17 package. In '85 you increased it once, and then in '86 you  
18 increased it again, so the change would be fully effective in  
19 '86.

20 The Chairman. Then that adjustment in the zero bracket  
21 would offset any increased cost to that consumer?

22 Mr. Brockway. Well, that is the hope. One of the  
23 problems in the distribution that Senator Baucus was asking  
24 about and others is that on any consumption tax it tends to  
25 be higher as a proportion of current tax for very low-income

1 people because they pay very little tax.

2 By increasing the zero bracket amount, that would tend --  
3 I think it averages about \$13 of tax increase for people  
4 between 0 and \$10,000 and then it gets up to the highest  
5 income groups. Over \$100,000, I think that the return might  
6 be \$5,000.

7 But it keeps the distribution of the total tax system  
8 roughly the same as it is right now.

9 The Chairman. Now, what about the question Senator  
10 Grassley raised this morning on the concern expressed by  
11 livestock producers?

12 Mr. Brockway. Well, we have looked at something and  
13 discussed it with his staff and they are examining it. But,  
14 basically, what it would do is exempt out from the rules  
15 regarding denial of deductions for prepayments for something  
16 to be delivered in the future -- it would provide an exception  
17 for farmers who materially participate in the conduct of a  
18 farm or farm corporations.

19 They would have a full year. At the end of the year,  
20 they could take delivery of the property and still deduct it.  
21 In other words, you could make a payment on December 31st and  
22 as long as you got it by December 31st, the next year you  
23 would still be able to deduct it in the first year.

24 Senator Bentsen. That is for any farm, be it  
25 individually owned or corporate-owned. Is that correct?



1 Mr. Brockway. This would be to both as long as there  
2 were material participation. Apparently, as a result of  
3 discussions, there is no one-year limitation whatsoever, in  
4 fact, for a farm.

5 But in a corporate farm, if the family controlled the  
6 corporation, they would also qualify. Let me check, but I  
7 think it would pick up the same rules that you have in the  
8 code right now on family farm corporations for accrual.

9 Senator Bentsen. You could take advantage of any dis-  
10 counts. You could buy the stuff, the fertilizer, the  
11 insecticide, if you wanted to, and take your delivery six  
12 months later and there would not be a problem?

13 Mr. Brockway. That is the intention of the change.

14 The Chairman. There were a number of areas raised  
15 yesterday in the Treasury's package of accounting reform and  
16 some of the other areas. One was in the royalty trust area  
17 and there was a question raised by somebody on the panel.

18 First of all, if this should pass the Committee and then  
19 pass the Senate and all that, we are probably looking at some  
20 time down the road. But is that so structured so it does not  
21 get involved in any present controversy?

22 Mr. LeDuc. As it is currently drafted, Mr. Chairman, it  
23 would apply to distributions after the date of Committee  
24 action unless pursuant to a plan adopted prior to the date of  
25 Committee action.

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So a taxpayer who merely contemplates making a distribution would be affected, and that may be the concern that Senator Bentsen highlighted yesterday.

The Chairman. I am not certain, you know, what will happen tomorrow or next month or in January. But it would seem to me that we had better look at that rather carefully.

Senator Bentsen. If something has to be done or should be done on that, we have not had hearings. Then I would think you would not have it taking effect in '84.

Mr. LeDuc. Senator, there were hearings on this proposal last month.

Senator Bentsen. Now, let us talk about those hearings a minute. We have talked about all these hearings on all of these various provisions that have been proposed. Would you tell me how long those hearings lasted?

Mr. LeDuc. The hearings occurred on the afternoon of Monday, October 23rd or 24th.

Senator Bentsen. So they occurred one afternoon?

Mr. LeDuc. Yes.

Senator Bentsen. Would you also advise me as to how many witnesses were testifying before that that were going to be affected by all this myrid of provisions, other than just Treasury and people like that?

Mr. LeDuc. Senator, excluding Treasury, there were approximately 20 witnesses. To the best of my recollection,

1 Senator, only one or two witnesses were unable to be scheduled  
2 because of time constraints; that is, all who requested oral  
3 testimony, with one or two exceptions, were heard.

4 Senator Bentsen. But all you had was one afternoon of  
5 total hearing on all of these provisions?

6 Mr. LeDuc. That is correct, Senator.

7 The Chairman. I think the point is before we make any  
8 judgment on that, we want to be certain that we have been  
9 fairly well ventilated.

10 Yes, Senator Boren?

11 Senator Boren. Mr. Chairman, I have to go back to a  
12 natural gas meeting in just a minute. I wonder if I might  
13 raise a couple of points here, especially while Senator  
14 Bentsen is here, on the miscellaneous items.

15 Mr. Chapoton is here. I think at least one of these  
16 issues might be taken care of just by a correction. On the  
17 Superfund bill, when that passed, as I recall, there was a  
18 colloquy on the floor between yourself and Senator Long about  
19 the petroleum-derived light hydrocarbons which are never  
20 isolated and, in fact, become blended components of gasoline  
21 and then, of course, are evaporated.

22 As I understand it, that colloquy stated that they were  
23 never intended to be taxed as chemicals as continuous products  
24 under the Superfund bill. And I was wanting to offer,  
25 depending on what Mr. Chapoton said -- I understood that he

1 said he might be able to take care of that by regulation  
2 without any necessity for legislation.

3 If not and if we felt we needed legislation, we should  
4 offer a technical correction on that.

5 Mr. DeArment. We have been studying that problem,  
6 Senator Boren. I know I have mentioned it to the Chairman,  
7 who participated in that colloquy, and I think the Treasury  
8 has been looking at it.

9 It is a matter that was raised in their proposed  
10 regulations which seemed to be at odds with the colloquy that  
11 occurred between then Chairman Long and Senator Dole, and  
12 similar colloquies between the Chairman and ranking member  
13 of the Ways and Means Committee.

14 Senator Boren. I just wondered if we could get a  
15 commitment from Treasury to make those regulations reflect  
16 that colloquy and the intent of the Committee. I would not  
17 feel it necessary to offer a technical correction. But if we  
18 cannot, then I would like for us to write a technical  
19 correction amending the law.

20 The Chairman. Well, why do we not do this? If there is  
21 any problem, we will include the technical corrections.

22 Senator Boren. All right. If there is a problem with  
23 the regulations, we would then include a technical correction.

24 Mr. Pearlman. We will pursue that.

25 Senator Boren. All right, but I would like to include

1 it if we do not get it worked out by regulations.

2 The Chairman. Right.

3 Senator Boren. Mr. Chairman, the second item, and I  
4 know Senator Bentsen has an interest in this, is we have had  
5 a lot of problems -- I think it is an understatement to say  
6 "problems" -- in the financial institutions in our part of the  
7 country.

8 I am not telling any secrets. Everyone knows the name  
9 of Penn Square and Midland Bank, and so on. We just had the  
10 largest bank in the state of Oklahoma two weeks ago indicate  
11 that they were increasing their loan loss reserves to above  
12 four percent, and that they had written off another \$60-some  
13 million.

14 And I know that the one percent loan loss reserve  
15 deduction is due to go down, I believe, to six-tenths of one  
16 percent this year. And I know in the proposals before us, I  
17 think you talk about changing the five-year look-back to a  
18 two-year look-back, or whatever.

19 It is my hope that we might consider a two-year  
20 moratorium on that reduction below the one percent level  
21 simply because to be prudent in our parts of the country  
22 right now, certainly the one percent is not even adequate, as  
23 I say, in many cases, with our largest institution going up  
24 above between three and four percent.

25 And I think it would be the wrong thing for us to do at

1 this point to do anything that would encourage the reduction  
2 of those loan loss reserves. I know it is true throughout  
3 the Southwest and I think it is true in the Farm Belt as well  
4 because of the problems in the agricultural sector.

5 I know Senator Bentsen has an interest in it. I just  
6 wondered if we might consider a moratorium on that.

7 The Chairman. I might suggest this is another area we  
8 are looking at. As you know, the bill on the Senate floor  
9 last night would have repealed this Domenici-Chiles tax bill.

10 Senator Boren. Yes.

11 The Chairman. I think staff has made one recommendation.  
12 Treasury has a different view.

13 Mr. Pearlman. Yes. I think we would concur with  
14 Senator Boren. We are in favor of continuing the one percent  
15 rule for a two-year period.

16 The Chairman. We thought we would trade something they  
17 are in favor of for something they are not in favor of a little  
18 later on.

19 Senator Bentsen. Let me state, Mr. Chairman, that I am  
20 delighted to hear that Treasury has finally changed their  
21 position on that because we have had quite a controversy on  
22 that in the past.

23 I led the effort to try to retain the one percent  
24 because they were talking about using the experience ratio in  
25 trying to determine what the reserve for loan losses would be.

1 When you try to extrapolate that into the kind of economic  
2 conditions we had during this recent recession, then you just  
3 do not have an experience background that means anything.

4 And now you have more banks in trouble than you have had  
5 at any time since the Great Depression. And the non-performing  
6 loans for some of the banks are really at a very high level.  
7 So, to talk about a further reduction in the reserve for loan  
8 losses at a time like this does not really make any sense.  
9 So I am delighted to see the Treasury change its position.

10 The Chairman. Well, we think we can work that out with  
11 Treasury.

12 Senator Symms. Mr. Chairman, I agree with what Senator  
13 Bentsen and Senator Boren both said. I think that, you know,  
14 we did have this controversy, and I agree with Senator  
15 Bentsen. I am glad that Treasury is seeing it this way.

16 I think we should definitely go the two years, but I hate  
17 to see us continue to have these little things in the tax code  
18 where it is just two years. I would rather just make it  
19 permanent and then if you want to change it later, you change  
20 it.

21 But you do not have this cloud hanging over everybody's  
22 head so that two years from now, because time goes by pretty  
23 fast, you come back in here. By then, somebody else may be at  
24 Treasury and they will say, "Well, let us lower that to a  
25 half a percent," and you go through the same hassle over and

1 over again. Why do we not just make it permanent and settle  
2 it?

3 Senator Boren. Mr. Chairman, I would love to make it  
4 permanent.

5 Senator Symms. If they want to change it later, they  
6 can change it.

7 Senator Boren. Let me say that I would take two years  
8 right now if that is --

9 The Chairman. I think we can work this out. I want to  
10 help the bankers wherever I can.

11 Senator Boren. I have told them, Mr. Chairman, that I  
12 know you would be very desirous of helping on that.

13 The Chairman. Seriously, I think this is a provision  
14 that I find myself in agreement with Treasury. But I think  
15 it falls in the same category of about nine others we have  
16 discussed.

17 When we finish the members' discussion and sit down with  
18 staff later this afternoon and try to hammer out the  
19 remaining --

20 Senator Boren. If we could just try to work out a  
21 package on that that would include the two-year moratorium.

22 Senator Danforth. Mr. Chairman?

23 Senator Boren. One last item -- are you ready to go?

24 Senator Danforth. Oh, no.

25 Senator Boren. I apologize because I have got to go back



1 down just briefly to this natural gas meeting.

2 The last matter is a matter that Senator Symms and I have  
3 an interest in and it relates -- in fact, we have discussed  
4 this several times, the problem we had last year on the  
5 piggyback road railer issue on the trailers, where we  
6 exempted the road railers from the fuel tax and we did not  
7 exempt the piggyback trailers that were also not used on the  
8 highways. We created an inequity between the two.

9 Now, we have had some testimony from the American  
10 Truckers Association. I know Senator Packwood was there at  
11 the time we had that testimony. They had some problems with  
12 it.

13 I understand that we have attempted to work out a  
14 compromise that would allow such an exemption, but would  
15 tighten up greatly the way in which this was certified; that  
16 the seller and the buyer, in addition to the standards for  
17 defining what they are, would be tightened up.

18 The seller and the buyer would have to certify that the  
19 trailer would not be intended to be used more than 10,000  
20 miles each year on the highway.

21 Senator Packwood. Who certifies that, the seller?

22 Senator Boren. The seller or the buyer. I know these  
23 negotiations have been going on. I do not know whether  
24 Treasury has been involved in that or not, but we do have a  
25 real problem because we have given a competitive advantage now

1 to one set of people that are in the very same business as  
2 the other set.

3 They are, in essence, operating vehicles to put them on  
4 the railroad and not on the highway. And there is a  
5 difference in cost in terms of modification for trailers.  
6 These trailers are smaller; they are not economical to really  
7 use in long distances on the road.

8 So I do think it is an inequity we need to deal with and  
9 I was hoping we would work that out.

10 Senator Packwood. Correct me, David, if I am wrong on  
11 this. I remember that hearing, but my mind is a little  
12 distant right now. As I recall the road railers, the evidence  
13 was very clear that they are hardly used on the road at all.  
14 Am I right on that?

15 Mr. Brockway. I think that is the reason why the road  
16 railers were exempted. They are basically used on trains.

17 Senator Packwood. When we got to the piggyback trucks,  
18 as I recall, the evidence was that companies that have them  
19 have a mix of piggybacks and others and they will use a  
20 piggyback truck on the highway if that is what they have got  
21 for hauling on the highway that day.

22 There was at least the allegation of a significant  
23 difference in mileage, and then we got into a debate between  
24 the proponents and the opponents as to how much mileage and  
25 who was going to monitor it.

1 That is about as much as I can remember right now. Maybe  
2 Treasury or --

3 Senator Boren. There was some difference of opinion  
4 about that. ATA, I think, has not been adamant about it. We  
5 have had further discussions with them trying to work out  
6 something. We do not want to create a loophole.

7 But at least one company, from actual mileage on their  
8 actual trailers -- they ran a survey of their actual trailers.  
9 They found that they were well below the mileage on the  
10 highway.

11 Senator Packwood. The reason I raised this, David, is in  
12 Oregon we have got log trucks. They are heavy log trucks,  
13 but they do not haul logs long distances. It is not  
14 economical; you do not haul logs 2 or 300 miles.

15 So they want some kind of an exception because they are  
16 not on the road very much. They pay the same use tax as  
17 trucks that use them 70, 80, 90, 100, 150,000 miles a year.  
18 I would have to go back and review that testimony, but  
19 something sticks in my mind that we had a dickens of a  
20 problem on differentiating not road railers, but almost  
21 everything else as to where the demarkation line would be as  
22 to when you are on the highway or how much you are on the  
23 highway.

24 The Chairman. Maybe Harry can help on that.

25 Mr. Graham. Yes, sir. The Senator is correct. During

1 the conference --

2 Senator Packwood. I cannot hear you, Harry.

3 The Chairman. Pull it up a little closer.

4 Mr. Graham. During the conference on the Surface  
5 Transportation Act, there were several discussions on how to  
6 exempt certain trailers that would primarily be used for non-  
7 highway use, such as there is currently an exemption for  
8 tires which are for non-highway use.

9 And the problem arose that it was hard to describe a  
10 demarkation line, as the Senator has indicated. Therefore,  
11 there were discussions over a de minimis rule. We have the  
12 de minimis rule in the heavy vehicle use tax where if it is  
13 not going to be used for more than 5,000 miles, then you do  
14 not pay the tax.

15 Senator Symms. Mr. Chairman?

16 Senator Boren. This is the excise tax we are talking  
17 about rather than the use. It is the excise tax.

18 Mr. Graham. Right.

19 Senator Boren. I think I helped draft the agricultural  
20 exemption, which is the 5,000 mile exemption.

21 Senator Symms. Mr. Chairman, just to kind of refresh  
22 everybody's memory, this top truck up here where the tractor  
23 is pulling it -- if you look right between the two back axles,  
24 there is a rail that they can jack down and put on a railroad  
25 and pull it on a railroad. That one is exempt.

1           The one right below it here where they are setting it on  
2 with the crane, that one is not exempt. I think that what  
3 Senator Boren is trying to do is fair.

4           I am aware of your concern about the logging trucks, Bob.  
5 I have had many of the same concerns and I do think that we  
6 should accept this amendment now that Senator Boren has. I  
7 think it is fair and equitable. And then next year -- I think  
8 the Chairman has already said this on the floor of the  
9 Senate -- we are going to readdress the whole truck use tax  
10 question.

11           The big support around the country now is to change the  
12 use tax that we passed to a fuel tax -- price differential  
13 between diesel and gasoline. And then we can address that  
14 logging truck question, and I think the logging trucks then --  
15 if they have any fuel that is exempted from highway use  
16 because they are not using it on the highways, that problem  
17 can be worked out and the fuel that they use on the highways --  
18 they will pay their fair share then.

19           So I think that you are both right, but I think that we  
20 ought to accept this amendment.

21           Senator Boren. Mr. Chairman, let me read the language.  
22 I have the language here that has been attempted to be worked  
23 out with the parties. It would say, "The Secretary should  
24 establish by regulation a certification procedure for  
25 compliance for the piggyback trailers. Such certification

1 shall take into consideration such factors as (a) that the  
2 trailer or semi-trailer has been built to specifications  
3 prescribed by the Association of American Railroads; (b) that  
4 it is included in the official intermodal equipment register  
5 as a piggyback trailer; (3) that it bears reporting marks  
6 issued or signed by the Association of American Railroads."

7 Further, it would provide for certification by the  
8 buyer or seller that it would be used less than 10,000 miles  
9 a year. All these are attempts to take into account the  
10 problem that Senator Packwood raised because I do not want to  
11 open this thing up.

12 What I want to do is provide that piggybacks that are  
13 really used the very same as road railers and are not used  
14 on the highways would get the same treatment because you, in  
15 essence, have really given a competitive advantage to one  
16 area of the industry over another.

17 Some just said, "Well, we are going to buy small trailers  
18 built a certain way that are not economical because they cannot  
19 carry the volume long distances to operate on a highway."  
20 They are too high-cost to operate very much on a highway.

21 You are giving a big advantage to others who said, "Well,  
22 we opt to buy the road railers." The only wisdom you can say  
23 for those who bought the road railers instead of the piggybacks  
24 back when they did it is that Congress adopted one policy for  
25 one and one for another. We are the ones who have caused the

1 inequity now.

2 The Chairman. Why do we not put this in the category of  
3 things to work on? Staff can work on it and bring it back to  
4 us in the morning to see if we have got some resolution that  
5 would satisfy the just concerns raised, if we can.

6 Would that be all right, David?

7 Senator Boren. Yes. I think Senator Durenberger might  
8 have an interest in this, too.

9 Senator Durenberger. Well, yes, I have a rather strong  
10 interest in it and I do hope we can work out some  
11 accommodation. It sounds like you have come very close to  
12 having the answer.

13 The Chairman. I am going to have to check this with the  
14 Department of Transportation tonight when I get home.

15 (Laughter.)

16 Senator Pryor. Mr. Chairman, if there is a meeting  
17 between the department and staff or whatever, I would  
18 certainly like to be included in that.

19 Senator Mitchell. And I also, Mr. Chairman.

20 The Chairman. Okay. Well, I know we are going to have  
21 another vote here in about 25 or 30 minutes, maybe sooner,  
22 and then we are going to get into, I think, a couple of  
23 amendments that Senator Long and I are going to have be there  
24 for.

25 What I would like to do on all the things that have been

1 raised is to give staff some time, because they have been up  
2 most of the night the last three or four nights, maybe from,  
3 say, 4:00 until 8:00 to go over all the loose ends, and there  
4 may be others we are not aware of.

5 And then maybe I could sit down with you and see where  
6 we are. Would that be all right, Senator Danforth?

7 Senator Danforth. Well, Mr. Chairman, just to state the  
8 term, the foreign tax credit issue on S. 1584, as altered --  
9 it is my understanding that that is acceptable, at least in  
10 principle, to Treasury, although there is a revenue cost in  
11 it.

12 I just want to mention that so it can be thrown into the  
13 hopper for consideration this afternoon.

14 The Chairman. We have discussed that informally. I  
15 think Rod DeArment is familiar with it. Mr. Pearlman, you are  
16 aware of what he is addressing.

17 Mr. Pearlman. Well, the only thing I am not aware of --  
18 there were three pieces to the bill and I am not familiar with  
19 what you are suggesting, Senator, on the final piece, the  
20 so-called LIFO (phonetic) provision, which we do oppose and  
21 we are not in favor of.

22 The Chairman. Well, we can get the material to you.

23 Mr. Pearlman. Okay.

24 The Chairman. Senator Moynihan?

25 Senator Moynihan. Mr. Chairman, it is my understanding



1 that this indefatigable panel up here has worked out a  
2 satisfactory arrangement with respect to covered call  
3 transactions in the markets, and that this would require, in  
4 effect, a Committee amendment in the nature of a technical  
5 change to section 111 of the reconciliation bill.

6 I wonder if I could ask if that is so, and understanding  
7 that it is, I would like to express my appreciation.

8 Mr. LeDuc. Senator, my understanding is that a rule  
9 for the covered call exception has been worked out to the  
10 satisfaction of the affected taxpayers. For covered call  
11 transactions involving options which are capital gain property,  
12 traded on an exchange, and are not deep in the money, the  
13 straddle rules would not apply.

14 For covered calls which are in the money, the holding  
15 period rules of the straddle rules would be applied; that is,  
16 you could not accrue a holding period if you wrote an in-the-  
17 money call unless you were deep in the money. However, the  
18 loss deferral and capitalization rules would not apply.

19 Senator Moynihan. That strikes me as eminently sensible,  
20 Mr. Chairman.

21 Senator Bentsen. I think you have addressed the abuses  
22 and really have tried to apply the ordinary tax provisions  
23 where they are participating in it for economic gain, really,  
24 instead of tax evasion or avoidance, if I understand you  
25 correctly.

1 Mr. LeDuc. That is our understanding, and the taxpayers  
2 have advised us that if abuses should develop, they will work  
3 with us to combat them.

4 Mr. Pearlman. Senator, that is also our understanding.

5 Senator Moynihan. Mr. Chairman, may I just say that  
6 that being the case, then we could --

7 The Chairman. Is there any objection to a Committee  
8 amendment? We can offer that to reconciliation then. Is that  
9 correct, Andre?

10 Mr. LeDuc. That is my understanding, Mr. Chairman.

11 Senator Moynihan. Thank you, Mr. Chairman.

12 Senator Durenberger. Mr. Chairman, I would like to go  
13 back and finish up the track clause discussion, either vote  
14 on it or --

15 The Chairman. Well, I think we are aware of the track  
16 thing. What I want to do is see if we can sit down with  
17 Treasury and see if there is any way we can make any progress.  
18 If we cannot, we will just have to vote on it tomorrow  
19 morning.

20 Senator Durenberger. Okay. Could I do ethanol fuels?

21 The Chairman. Go to ethanol, yes.

22 Senator Durenberger. I believe there are a number of us  
23 that have dealt with the whole issue of ethanol fuels and the  
24 current five-cent exemption from the highway excise tax. I  
25 will not make the large agricultural and environmental

1 argument for ethanol.

2 I would just say that this amendment would increase the  
3 excise tax exemption from five cents to nine cents, which is  
4 what we did on the tax bill last year. We came out of  
5 conference committee with only five cents.

6 Now, probably the main reason that we are recommending  
7 going to the nine cents is to, in effect, federalize the  
8 ethanol fuels exemption. Right now, there are at least 34  
9 or 35 states in the country that have state taxes, usually  
10 in the neighborhood of about four cents.

11 But in addition to that, they put in state incentives of  
12 one kind or another. For example, all the corn has to be  
13 home-grown corn or whatever, or they have a variety of  
14 expiration dates in them; they have a variety of amounts.

15 The net effect is we cannot build a national alcohol  
16 fuels industry when we have this variety of situations all  
17 over the country.

18 Senator Symms. Would you like to yield for a question?

19 Senator Durenberger. Certainly.

20 Senator Symms. I did not want to interrupt before you  
21 completed your argument, but would you like to fix this so  
22 that you just have the exemption on the alcohol fuel?

23 I mean, what this is doing to the highway program in this  
24 country is really devastating because you mix one gallon of  
25 alcohol in with nine gallons of gasoline and they sell it as

1 gasohol and have the exemption, if I understand it correctly,  
2 on all ten gallons.

3 If we are going to grant this exclusion for alcohol,  
4 what we should do is grant the exclusion on the alcohol fuel  
5 and not on the whole -- in other words, on the ten gallons  
6 you ought to get the exemption on the one gallon that is  
7 alcohol, and on the nine gallons that are gasoline, you ought  
8 to pay the tax.

9 Mr. DeArment. Senator Symms, that would substantially  
10 cut back, even if you did it on the full nine cents --

11 Senator Symms. I agree, but how many billions of  
12 dollars is this going to cost the highway program?

13 Senator Durenberger. We propose to replenish the highway  
14 trust fund. We have not figured out exactly how to do it,  
15 but that is part of this proposal.

16 Senator Symms. I had a slip around here -- and somehow  
17 in all the confusion of the votes I have lost it -- from the  
18 state of Iowa, for example, talking about just what it cost  
19 in Iowa. It runs into hundreds of millions of dollars and  
20 they have never had any of it replenished, and now they are  
21 coming down here hollering for more federal highway funds  
22 because they do not have any state highway funds.

23 Senator Durenberger. Well, that may be the case.

24 Senator Symms. This is politically sensitive for  
25 somebody from Iowa. I realize Senator Grassley is not here,

1 but it is --

2 Senator Durenberger. Well, he is around, he is  
3 available and he is a co-sponsor of the Act.

4 I will just finish off the explanation. Right now,  
5 along with the excise tax exemption, there is the matter of  
6 tariffs. In the past, we have combined each penny of  
7 exemption with a dime of tariff on imported alcohol. In  
8 effect, I would propose that we keep that same ratio so that  
9 we would be going to 90 cents.

10 Now, the effective date would be July 1 of '84, which  
11 would give the states time to repeal their own laws.  
12 Secondly, we would replenish the highway trust fund. My  
13 recommendation is we do it from the general fund for amounts  
14 lost to the highway fund.

15 I had thought about the windfall profits tax, but that  
16 is a horse that we are trying to beat to death, I guess, so  
17 that did not seem to be an appropriate place to go.

18 I would just say this recommendation comes from a whole  
19 lot of people, but it also includes the National Conference  
20 of State Legislators. The Midwest governors just passed a  
21 resolution on this.

22 Everybody is trying to avoid more PIK programs and a  
23 variety of other things, and I think the alcohol fuels industry  
24 believes that with the right set of incentives -- there are a  
25 lot of incentives around right now. The problem is you

1 cannot create a national industry around them because there  
2 are 35 different sets of incentives.

3 So this is just designed to get us to a level which is  
4 currently comparable to the approximately nine cents that  
5 exists anyway, but it will be a federal tax rather than a  
6 combination of federal and state tax.

7 Senator Danforth. Mr. Chairman?

8 The Chairman. Let me just suggest on this that that  
9 will be another one that we will be discussing between now  
10 and 8:00.

11 Senator Danforth. I would just like to note an objec-  
12 tion to the tariff part of it. Ambassador Brock has written  
13 you a letter taking a position against that provision and I  
14 would also oppose it.

15 Mr. DeArment. We have received that letter, Mr.  
16 Chairman, and Ambassador Brock makes the point that this has  
17 raised objections. Objections have been raised by the  
18 Brazilians on the last tariff that we imposed and those  
19 compensation arrangements have been negotiated right now  
20 and this would upset those negotiations that have just  
21 concluded.

22 The Chairman. We might make a copy of that letter a  
23 part of the record, if that is all right.

24 (The following was received for the record.)  
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THE UNITED STATES TRADE REPRESENTATIVE  
WASHINGTON  
20506

November 9, 1983

The Honorable Robert Dole  
Chairman, Committee on Finance  
United States Senate  
Washington, D.C. 20510

Dear Bob:

This is to express the views of the Administration regarding S. 1931, a bill "to amend the internal revenue code of 1954 to revise the tax incentives for certain alcohol fuels."

The Administration is strongly opposed to the tariff increase provided for in S. 1931.

S. 1931 would increase the U.S. tariff rate on ethyl alcohol for fuel use by \$.40/gallon. The internationally bound rate of 3% has already been increased by \$.50/gallon through legislation in 1980 and 1982. This bill would raise the tariff to a total of \$.90/gallon plus 3% ad valorem.

As a matter of general policy, USTR opposes bills which would increase duties on items bound in the General Agreement on Tariffs and Trade (GATT). Under the international trading rules of the GATT, a country which increases the duty on a bound item is obliged to pay compensation to affected trading partners or face retaliation. Compensation is usually paid in the form of lower tariffs on other items furnished by the supplying countries. As a general rule, we attempt to avoid trading increased protection for one U.S. industry or sector in return for reduced tariff protection for other industries or sectors.

We have recently concluded negotiations with the Government of Brazil regarding compensation for the earlier tariff increases on ethyl alcohol. The Brazilians agreed to suspend their claim for compensation under Article XXVIII of the GATT in return for the reduction of the U.S. tariff on canned corned beef as provided for in section 122 of H.R. 3398. Enactment of additional tariffs on ethyl alcohol would jeopardize this agreement and force us to reopen the compensation discussions.

There are procedures under current law to provide relief from imports if they are being traded unfairly, if they threaten a domestic industry with injury, or if the national security requires the protection of domestic capacity. A tariff increase such as that proposed in S. 1931 circumvents these procedures and makes it more difficult for the United States to convince

our trading partners not to take similar protectionist actions.

The Office of Management and Budget advises that from the standpoint of the Administration's program there is no objection to the presentation of these comments.

Very truly yours,



WILLIAM E. BROCK

WEB:stc



1 Senator Mitchell. Mr. Chairman?

2 Senator Symms. Mr. Chairman?

3 The Chairman. Senator Mitchell?

4 Senator Mitchell. I just wanted to say that notwith-  
5 standing Ambassador Brock's objection, I would like to express  
6 my support for Senator Durenberger's proposal and ask that  
7 if there are staff meetings that my staff be invited to  
8 participate. I think it is a very good proposal.

9 Senator Symms. Mr. Chairman, I would just like to make  
10 one other point about this. When the price of corn, and so  
11 forth, was a lot cheaper than it is now, that is when the big  
12 push came that we needed to have this place to get rid of all  
13 this surplus.

14 Now, prices of corn are a lot higher and we are still  
15 trying to get a bigger and bigger transfer. Now, you know, I  
16 think we have to think about it before we go into it. I  
17 would not object to it.

18 I mean, I come from a farm state and even though the  
19 agricultural college at the University of Idaho has done a  
20 lot of work on gasohol and they say it is absolutely not  
21 economical for the United States and there are all kinds of  
22 other energy sources that are more efficient for us to use  
23 in this country --

24 Senator Heinz. Apples.

25 Senator Symms. Apples are good.

1           The Chairman. Potatoes.

2           Senator Symms. Potatoes.

3           But the point I am making is that if we do this and  
4 continue to make this full exemption, you are not making a  
5 gallon exemption, and the Senators need to realize that. You  
6 are making an exemption that is ten times as much as how much  
7 alcohol there is because they put one gallon per ten and  
8 then they get a ten-gallon exemption.

9           So, sooner or later, you are going to have be faced with  
10 the problem of the highway program again and the highways  
11 breaking up. And you have got states that are oil and gas-  
12 producing states; my state is not one of them.

13           But in some cases, some of those states pay more money  
14 into the highway trust fund than they get back and there is  
15 just a gross inequity here that will take place if you  
16 continue to do this.

17           The Corn Belt will be wanting to get all the money from  
18 the oil-producing states and not pay any taxes on their  
19 highways. That is what we are talking about doing and it is  
20 going to cause a division sectionally in the country that I  
21 think we ought to avoid.

22           We should not go any further with this until we look at  
23 that whole question. I think if you want to have a nine-  
24 cent a gallon exemption, do it, but just do it on the one  
25 gallon that is alcohol and do not do it on the other nine

1 gallons out of every ten.

2 Mr. DeArment. Senator, does your proposal require that  
3 the states repeal theirs?

4 Senator Durenberger. No, because it is a little  
5 impractical to try to find out that requirement. What all the  
6 governors have told us and what the Conference of State  
7 Legislatures has told us is if we go to nine, they are going  
8 to repeal.

9 So we have given them six months to see whether that is  
10 a fact or not, and if they do not I guess we can come back and  
11 make a different judgment. But all of those states are the  
12 ones that want alcohol fuel production so I think the  
13 incentives are all there for them to get out of it.

14 The Chairman. Okay. Well, this is another one we will  
15 have to look at. I think another thing we need to address --  
16 maybe just Treasury can focus on some of the provisions in  
17 the so-called \$13 billion package.

18 Mr. Chapoton. Concerns have been expressed about it;  
19 that is right.

20 The Chairman. I think in the property and casualty area  
21 and some of these areas where we know we are going to have  
22 a great deal of opposition, and maybe with some justification  
23 because we are waiting on the GAO final report and some other  
24 things, I do not think we want to move into some areas where  
25 we are not certain.

1 But as I understand it, in most areas we could probably  
2 move forward.

3 Mr. Chapoton. We are going back through the package with  
4 that in mind, Mr. Chairman.

5 The Chairman. So, without objection, then maybe we will  
6 give the staff about three or four hours just to work it out  
7 with other interested staff members, depending on the issue.  
8 And then maybe about 8:00, I could get together with you and  
9 see how you are coming, and then we will meet again tomorrow  
10 morning at 9:30 and we will postpone or move the hearing  
11 scheduled on -- maybe the Judiciary Committee is available.

12 Is that all right?

13 Senator Danforth. I hate to postpone it. I would  
14 rather be meeting with the Committee than having a hearing  
15 tomorrow.

16 The Chairman. You are right. I think this is more  
17 important than the disc (phonetic) hearing. Who do we have  
18 as witnesses, out-of-town witnesses?

19 Mr. DeArment. We do have some out-of-town witnesses.

20 The Chairman. What time is that scheduled?

21 Mr. DeArment. Ten o'clock.

22 The Chairman. Well, maybe what we might do is meet at  
23 9:30. I think we could work it out so we can at least hear  
24 the out-of-town witnessses, if they are here, and then the  
25 others can come back. If we could do it right down the

1 hallway, if we could get a room, we would not keep you from  
2 this.

3 It is probably a little late to notify somebody from  
4 L.A.

5 Mr. DeArment. We have the Governor of the Virgin  
6 Islands.

7 (Laughter.)

8 The Chairman. Maybe we could just go there and have it  
9 during the recess.

10 (Laughter.)

11 Mr. DeArment. I think Ron Pearlman will be here anyway.  
12 Bob Leidheiser can come back.

13 The Chairman. Yes, Leidheiser can come back. Well, we  
14 will try to work that out if there are witnesses coming, but  
15 I think we should try to see if we could wrap this up  
16 tomorrow.

17 (Whereupon, at 3:42 p.m., the Committee was adjourned.)  
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