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HEARINGS

Before the

COMMITTEE ON FINANCE

# UNITED STATES SENATE

MARKUP: S. 1564, LEASING AND TRADE ADJUSTMENT ASSISTANCE

Washington, D.C.

Wednesday, September 28, 1983

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6 Committee on Finance

7 Washington, D. C.

8 The Committee met, pursuant to notice, at 10:50 a.m., in  
9 Room SD-215, Dirksen Senate Office Building, the Honorable  
10 Robert J. Dole (Chairman of the Committee) presiding.

11 Present: Senators Dole (presiding), Packwood, Danforth,  
12 Chafee, Heinz, Durenberger, Grassley, Long, Bentsen, Moynihan,  
13 Boren, Bradley and Pryor.

14 - - -

15 The Chairman: We have been delaying just for a few minutes  
16 because we are trying to accommodate the people in the hallway.  
17 We can't find any other meeting room, so we have asked if they  
18 might pipe a little sound into the hallway itself if it doesn't  
19 disturb any other office, because I know many people have an  
20 interest in -- at least I assume they have an interest. They  
21 wouldn't just be here because it is so exciting. So, we want  
22 them to hear so they can go back and report to whoever they  
23 report to.

24 When we concluded yesterday we were getting into a  
25 discussion of the whole public property leasing, and I

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1 understand there may be one or two amendments which we want to  
2 discuss and go over with the Treasury. Mr. Chapoton is here.  
3 I don't think we are going to make any final action on  
4 amendments today.

5 I must say, this is a very, very complicated area and  
6 amendments are coming out of the woodwork, and we hope they go  
7 back into the woodwork, many of them.

8 But where did we leave off? I am not certain I understood  
9 just what happened.

10 Andre, David explained generally what the bill did,  
11 Mr. Brockway, and then you were getting into a few particulars.

12 Mr. Leduc: We had described one type of transaction. It  
13 might be helpful to recapitulate that transaction and the three  
14 other principal types of financing transactions which this bill  
15 would effect.

16 The Chairman: Okay, let's do that, you know, rather  
17 hurriedly.

18 Mr. Leduc: The bill is, in theory, designed to prevent  
19 negative tax rates. That is, it is intended to prevent a tax  
20 exempt entity from transferring, essentially selling, tax  
21 benefits which it cannot realize because it is tax exempt to a  
22 taxable entity and so achieve an effective negative tax rate.

23 Four principal types of transactions have been identified:  
24 Leases or sale lease-backs by private colleges and charitable  
25 organizations and other tax exempt organizations; leases by

1 state and local governments which are tax exempt; leases by the  
2 Federal Government itself, which of course is tax exempt; and  
3 leases by foreign persons who are not taxed in the United States.

4 The transactions are substantially similar but raise  
5 slightly different issues. Let me run through just in outline  
6 a couple of paradigms.

7 The Bennington College case has received some attention and  
8 it exemplifies a series of transactions which have been done or  
9 contemplated by private colleges and other tax exempt entities.

10 The tax exempt has substantial real or personal property.  
11 Because it is tax exempt it cannot claim the investment tax  
12 credit or the deferral from accelerated cost recovery  
13 deductions.

14 It may, therefore, transfer tax title to a taxable entity  
15 which will then be eligible to claim the credit for  
16 rehabilitation expenses and to utilize the subsidy available  
17 from the mismatching of income and deductions under the  
18 accelerated cost recovery system.

19 In Bennington's case, the transfer would be of the entire  
20 campus. Smaller transfers are contemplated by other colleges  
21 and universities.

22 The Chairman: Are there a number of colleges and  
23 universities getting ready to sell the campus?

24 Mr. Leduc: Yes, sir.

25 The Chairman: Football teams or things like that?

1 Mr. Leduc: There have been stadiums, there have been  
2 dormitories at both private and public institutions. Many of  
3 these projects are still in the planning stage and the planning  
4 has been slowed down by the introduction of the legislation in  
5 the House and the Senate.

6 The principal issue raised by a Bennington type  
7 transaction is the transfer of the tax benefits. The rents are  
8 reduced when the property is leased back to the private college,  
9 thus passing through the benefit of the cost recovery  
10 deductions and effectively yielding, in our judgment, a negative  
11 tax rate.

12 Aside from alumni reluctance to enter into these  
13 transactions, there are no checks and no limits by the Federal  
14 Government on the volume of such transactions.

15 Similar transactions are done by state and local  
16 governments. The Atlanta City Hall is one example in which the  
17 city leases the city hall to a private investor, sells and  
18 leases back.

19 The issues are substantially identical. The taxable  
20 entities can claim the investment credit for the rehabilitation  
21 and the accelerated cost recovery deduction.

22 There is an additional concern. In general, when a state  
23 or local government issues tax exempt bonds, limits are put on  
24 the reinvestments of the proceeds. There are anti-arbitrage  
25 restrictions.

1           There are no anti-arbitrage restrictions on sale lease-backs,  
2 so you can sell the city hall and put it in taxable bonds paying  
3 a higher yield. Of course, the city is tax exempt so it pays  
4 no tax on the taxable bonds.

5           A third type of transaction, epitomized by the Navy lease  
6 of the TAKX and T-5 tankers, is a lease by the Federal  
7 Government.

8           The Federal Government, again, is not a taxpayer, is not  
9 entitled to the investment credit or the benefits from ACRS.  
10 So, rather than buying the property itself, the Federal  
11 Government arranges to have a private party buy it and enters  
12 into a long term lease. The rents are reduced to reflect the  
13 tax benefits to the private party and the Federal Government is  
14 able to reduce its appropriations, its direct spending.

15           The Chairman: As I understand, they may reduce the  
16 appropriations, but is it correct that it may be more costly  
17 because of revenue loss than it would through the appropriation  
18 route?

19           Mr. Leduc: Mr. Brockway's staff has studied that closely  
20 and he may want to comment, Senator.

21           Mr. Brockway: Mr. Chairman, any of the leases ---

22           The Chairman: If we may have order, I know it is difficult,  
23 we have a crowded room, but we would like to better understand  
24 this very complex matter.

25           Dave?

1 Mr. Brockway: Mr. Chairman, in any of the leases to the  
2 Federal Government you are almost certainly going to have a  
3 higher aggregate cost to the Federal Government when you take  
4 into account the impact of the tax losses to the Treasury and  
5 the amount that the federal agency -- in this case, the Navy --  
6 is going to pay.

7 In that transaction, using our methodology -- I think the  
8 Treasury reached similar results using somewhat different  
9 methodology -- the conclusion was that on ships costing about  
10 \$2.3 billion, it increased the aggregate cost to the Federal  
11 Government by about 13 percent.

12 The Chairman: Through the leasing?

13 Mr. Brockway: Through the leasing, because you have two  
14 things going on. One is that there is a certain amount of  
15 inefficiency. The private investor is going to want some return.  
16 And in addition, if the Federal Government does it, it does it on  
17 its credit, which is the best credit in the economy, and by  
18 running it through a lease transaction the private investors, in  
19 order to fund the project, will have to pay higher interest  
20 costs which ultimately will have to be passed through to the  
21 Federal Government.

22 The Chairman: Why do we do it, then? I mean, if we are  
23 punishing the taxpayers either way, but we are going to punish  
24 them more this way, why do we pick out the most severe  
25 punishment?

1 Mr. Brockway: Well, I think that for the agencies  
2 involved, when they examine it they haven't necessarily taken  
3 into account the tax cost to the Treasury Department because  
4 they aren't clearly measurable. And if entity bought it -- in  
5 other words, if the Navy spent the \$2.3 billion on the ships,  
6 that would have come out of appropriations in the year they  
7 acquired them. This way, the lease payments come out of the  
8 operations and maintenance budget and so -- I don't know what  
9 the lease payment might be, but 100, 200 million a year, much  
10 smaller, and they can spread it out and from their perspective  
11 it is much cheaper.

12 The Chairman: Treasury, do you agree with the comments  
13 made by the Joint Committee?

14 Mr. Chapoton: Yes, basically, Mr. Chairman. There is an  
15 argument back and forth on the total cost to the Federal  
16 Government, whether it is more if the transaction is a leasing  
17 transaction rather than a straight purchase by the government  
18 agency involved.

19 There is, I think, as Mr. Brockway says, clearly in  
20 virtually every case some inefficiency that has this impact that  
21 means more cost is involved. But even if you assume there is  
22 not, we think the major consideration is twofold.

23 One is the budgeting impact, the budget problem, whose  
24 budget the cost, the full cost should appear on. And then  
25 secondly, the use of the federal credit, more expensive credit



1 if it is not the federal credit.

2 So, we supported these changes, of course, on the House  
3 side for that reason.

4 The Chairman: Do you want to get in the last category?  
5 Then I assume other members have questions.

6 Mr. Leduc: The final category is foreign leasing. The  
7 United States taxes its citizens and residents and other persons  
8 doing business in the United States. Foreign persons not doing  
9 business in the United States are not taxed.

10 Nevertheless, it is possible for such persons to lease  
11 property from a United States financial intermediary. That  
12 financial intermediary will be entitled to certain accelerated  
13 deductions for depreciation and, in some instances if the  
14 property is being used to ship into the United States or, in the  
15 case of airplanes, to fly back and forth, there will also be an  
16 investment tax credit available.

17 The Chairman: Let's get that down to an example. Let's  
18 say Citibank and some French airline. How does it work?

19 Mr. Leduc: If the French airline, for example, were flying  
20 between Paris and New York on a regular basis with the planes,  
21 a 10 percent investment tax credit would be available.

22 The Chairman: Though it is made in France?

23 Mr. Leduc: If it were made in France, the Concorde, for  
24 example, the credit would be available and accelerated.  
25 depreciation would be available.

1 The only United States interest would be -- in a general  
2 lease, lease terms are up to 18 years for commercial aircraft.  
3 If the lease were entered into last year, in the year 2000  
4 Citibank would be entitled to the airplane.

5 In the interim, of course, it would be entitled to the  
6 rental payments and the tax benefits.

7 The Chairman: So, what makes then eligible is financing.  
8 Is that correct?

9 Mr. Leduc: That is correct, Senator.

10 Senator Moynihan: Mr. Chairman, could we discuss this at  
11 length, please? There is a lease sector in the finance  
12 community. It is principally engaged in leasing abroad products  
13 made here, and I would hope when we come to some general  
14 discussion of this that we take that up.

15 The Chairman: There is a distinction, right.

16 Senator Moynihan: And there is a distinction.

17 The Chairman: There is a distinction. They are made  
18 here.

19 Senator Moynihan: That is correct.

20 The Chairman: That is not a problem.

21 Mr. Leduc: But under present law there is no restriction of  
22 the current benefits to property manufactured in the United  
23 States.

24 Mr. Chairman, that gives you an overview of the types of  
25 transactions that would be affected by this legislation.

1           The Chairman: I know every member probably has an  
2 interest. What we have tried to do at a staff level was to have  
3 both the Joint Committee and our staff sort of go over the  
4 general program, and what I thought we might do, without acting  
5 on any amendments -- we are trying to figure out if we are going  
6 to end up saving revenue or losing revenue. Here is a bill that  
7 ought to pick up \$5 billion over the next three years. If it  
8 gets whittled away with all these amendments, it will be costing  
9 the Treasury \$5 billion. And I think on the face of it, it is  
10 pretty hard to justify someone who is tax exempt being able to  
11 sell credits and unused ITC's or whatever when they don't pay  
12 taxes in the first place. I think we have to start with that  
13 proposition.

14           But let's go down the list of a few that have been raised  
15 in the Committee by colleagues, either in letters to me or to  
16 other members.

17           Let's start with solid waste, waste water and renewable  
18 energy facilities. That is a matter that has been raised by  
19 a number of colleagues.

20           Have you had a chance to review that amendment, or  
21 proposal? Put it that way.

22           Mr. Leduc: Mr. Chairman, the staff of the Joint  
23 Committee and our staff and the staff of the Treasury has spent  
24 some time with the special problems that are raised with solid  
25 waste, waste water processing facilities, and renewable and

1 other alternative energy facilities.

2 S. 1564 and the corresponding House bill seek to draw the  
3 line between service contracts and leases. If property is  
4 leased to a tax exempt, no investment credit is allowed under  
5 current law, and under the bills no accelerated depreciation  
6 would be permitted.

7 Under a service contract, by contrast, both tax benefits  
8 are available.

9 The approach taken in both the House and the Senate bill is  
10 to identify the factors that should be considered in making that  
11 determination.

12 The industries I mentioned raised concerns that there was  
13 substantial uncertainty as to how those factors would be applied  
14 and asked for clarification.

15 Senator Bentsen: Mr. Chairman, let me interrupt him right  
16 now, because I am not sure I understood the first part of the  
17 leasing arrangement and what is in effect now. I don't think you  
18 were quite clear on that.

19 Would you restate that part of it? What is available,  
20 ACRS, investment tax credit, and so on? Make you point.

21 Mr. Leduc: Senator, under present law we draw a  
22 distinction for the investment credit between property which is  
23 leased to a tax exempt entity for which no investment credit is  
24 available and property which is used by a service provider ---

25 Senator Bentsen: I understand that. I just want you to

1 tell me that on the lease portion. You stated something that  
2 you didn't make clear to me. Just tell me what the law is now  
3 on the leased provision.

4 Mr. Leduc: There is accelerated depreciation available,  
5 Senator, but there is no investment credit.

6 Senator Bentsen: All right. You didn't make that point  
7 clear. Thank you.

8 The Chairman: Go ahead, Andre.

9 Mr. Leduc: As a result of the concerns with uncertainty,  
10 the suggestion was made that we should, instead of identifying  
11 a list of factors to be considered, we should provide a  
12 comprehensive test for such property to determine whether it was  
13 a service contract or a lease, and three factors have been  
14 identified.

15 First, who is in operating control of the property? If  
16 the taxable entity is operating the facility, that counts, that  
17 must be satisfied in order to find it a service contract. That  
18 is, if the tax exempt is operating the facility, no investment  
19 credit would be permitted and, under the legislation, no  
20 accelerated depreciation would be permitted.

21 The Chairman: An example of that would be, say, in  
22 Boston, whether it is Wheelabrator Frye operating -- near  
23 Boston -- or the city. Is that what you are suggesting?

24 Mr. Leduc: That is correct. Where the private contractor  
25 is running the facility, which is the case in the Saugus

1 facility.

2 If it were a new facility, the credit and the depreciation  
3 would be available.

4 Additionally, we would require that the taxable entity  
5 reap the benefits and bear the burdens of running the facility.  
6 That is, the potential for profit if the project performs above  
7 contract and the risk of loss if it doesn't work must remain on  
8 the taxable party.

9 So that if there is a significant profit participation or  
10 a significant risk ---

11 The Chairman: That is two. Is there a third item?

12 Senator Bentsen: Excuse me. I am trying to understand.  
13 What are you striking at? A net, net, net, something where  
14 there is no risk involved?

15 Mr. Leduc: Or where there is a regulated return, Senator.

16 Senator Bentsen: All right.

17 Mr. Leduc: Risk of loss, risk of benefit, and control,  
18 those are the three factors.

19 The Chairman: Now, as I understand, and I know Senator  
20 Durenberger has an interest in this and other Senators have,  
21 there has been a lot of discussion with the principals  
22 involved and with staff at our level. I am not certain, I think  
23 also maybe with Treasury.

24 Has there been any way we could reconcile the interests  
25 involved here and work out some satisfactory arrangement without

1 great losses?

2 Senator Durenberger: I was given the impression last night  
3 that we were extremely close to having reconciled some of these  
4 differences. I have not seen the language yet, Mr. Chairman.  
5 I suspect after I have had an opportunity to take a look at the  
6 language ---

7 The Chairman: We might hear from Treasury to see.

8 Mr. Chapoton: Mr. Chairman, we have been given some  
9 language this morning that basically appears acceptable to us.  
10 Now, I am not certain, Senator Durenberger, this is the language  
11 you are talking about or not.

12 The Chairman: I am not certain we are ready for the  
13 language.

14 Mr. Chapoton: Well, this type of approach, which simply  
15 tries to be a little more specific on what type of activity will  
16 result in a service contract as opposed to a lease, and basically  
17 the thrust is that the private entity has to both operate the  
18 facility and bear risks from the operation of the facility.  
19 Those are the key points.

20 The Chairman: What I thought we might do, in this  
21 particular piece, if we are near some agreement, rather than to  
22 try to hammer that agreement out, we could work it out with the  
23 principals who have an interest in it and bring it back up  
24 tomorrow or -- we are going to be on this for several days,  
25 believe me -- and dispose of the areas we can.

1 Is that satisfactory?

2 Senator Moynihan: I would appreciate that opportunity.

3 Senator Bradley: I think that is a good idea. From what  
4 I have heard about the language that was worked out overnight on  
5 who has operating control and who bears the risk and who gets  
6 the economic benefits, it seems to me that it sounds like it is  
7 okay, but I would like to reserve a right to see the actual  
8 language.

9 The Chairman: Okay. Let's do this, let's have the Joint  
10 Committee and our staff and the Treasury meet with the -- we are  
11 all interested and if we can hammer that one out, that is one  
12 less. It only leaves 8,003 amendments. So, that will be  
13 helpful.

14 Another area that has been called to my attention by  
15 Senator Ford, primarily, and other Senators, has been the  
16 Rural Electric Cooperative. I know there is a difference of  
17 opinion on this one, no agreement has been reached.

18 But either Andre or Dave, can you sort of outline that  
19 provision?

20 Mr. Leduc: Under S. 1564 no limits are placed on tax  
21 exempt entities which become taxable and subsequently enter into  
22 leasing transactions.

23 Under the House bill a restriction would be imposed so that  
24 an entity which within five years had been tax exempt is not  
25 permitted to -- is treated as a tax exempt entity and so is



1 subject to the limitations of the bill.

2 The theory -- and Mr. Brockway may want to comment on it in  
3 more detail -- is to prevent taxpayers from becoming taxable in  
4 order to transfer the tax benefits.

5 The Chairman: And going back and forth?

6 Mr. Brockway: Basically, that is it, and I think that  
7 another one of the concerns is that the taxpayer can wait until  
8 they are about to make a very large capital purchase and at  
9 that point voluntarily switch on to be taxable and perhaps  
10 frontload some of their income during the tax exempt stage.

11 And so, what the theory of the House bill is to say that  
12 if you have been taxable for some period of time -- that is,  
13 five years -- then you are treated as any other taxable  
14 utility. If you haven't been, then you are subject to the  
15 restrictions of the bill.

16 It is the same rule that was in last year's legislation  
17 dealing with safe harbor.

18 Senator Bentsen: Mr. Chairman, on that one isn't some  
19 progress being made on the possibility of a compromise to stop  
20 the switching in and out, which is a very legitimate complaint,  
21 I believe, where you shouldn't allow them to do that?

22 The Chairman: I think that is true, but I understand that  
23 Treasury still does not agree. If we do that even, there is  
24 still, what, a billion and a half dollars revenue lost.

25 Mr. Chapoton: That is correct, Mr. Chairman. These are big

1 dollars because we are talking about high cost equipment, and  
2 the question is whether an entity that is basically a tax exempt  
3 entity ought to have any benefit here.

4 The Chairman: I guess the theory is that they don't pay  
5 taxes even though they are taxable.

6 Mr. Chapoton: Well, the point has been made. I am not  
7 certain that is absolutely correct.

8 The Chairman: That is what I have heard. I don't know  
9 whether that is true or not.

10 Mr. Chapoton: That point is made.

11 Senator Boren: Excuse me. Has a compromise been worked out  
12 on the cooperative matter?

13 Mr. Leduc: No.

14 Senator Boren: It has not at this point?

15 The Chairman: No. We are discussing all these, where they  
16 are working on efforts to work out a compromise. But the  
17 Treasury has a different view than the industry.

18 The industry would say, which I think is a good concession,  
19 that they would become taxable. Is that correct?

20 Mr. Leduc: And they would stay taxable for a period  
21 extending beyond the recovery period for the leased property.

22 Senator Boren: For a 15 year period.

23 The Chairman: Treasury is saying that is great, but that  
24 still doesn't address the rather substantial loss problem.

25 Mr. Chapoton: That is correct. They are not going to pay

1 any tax during that period in any event. We can look at an  
2 approach along that line further, but I think you have really  
3 swept the problem under the rug if you do that, because they are  
4 not going to be -- basically would not be taxable, even though  
5 nominally taxable for that period of time.

6 The Chairman: How did the House handle it?

7 Mr. Chapoton: The House said, if it had been tax exempt  
8 in the last five years, it is exempt for these purposes.

9 The Chairman: Well, is there some other approach we might  
10 use? Maybe we leave that as we did the last item, maybe  
11 Treasury and staff and others who have an interest can -- this  
12 is going to be a rather large problem.

13 What is the next item? That is hospital equipment?

14 Mr. Leduc: Yes, sir.

15 The Chairman: CAT scanners.

16 Mr. Leduc: The bill as introduced has an exception for  
17 short lived property which permits short term leases without  
18 making those leases subject to the limitations of the bill.

19 The concern was raised that the ADR system, which is the  
20 prior depreciation system that preceded the accelerated cost  
21 recovery system, was inaccurate with respect to certain  
22 sophisticated hospital equipment and that, in fact, such  
23 equipment is short lived property.

24 One proposal that would deal with some of those concerns  
25 would be to grant the Treasury authority to repromulgate a class

1 life for hospital equipment, and in the interim to treat such  
2 equipment as short lived property.

3 The Chairman: As I understand that are, there may have  
4 been some agreement with Treasury. No?

5 Mr. Chapoton: Well, that type of approach is acceptable to  
6 us. As I understand it, it would basically say this is short  
7 lived property and therefore is without the coverage until we  
8 specify what they think would be a more -- what the argument  
9 would be, would be a life consistent with the economic life of  
10 the property.

11 The Chairman: Am I correct that that would be a satisfactory  
12 resolution of this issue?

13 Mr. Leduc: That is my understanding, Mr. Chairman, provided  
14 that the Treasury rules operated prospectively.

15 Mr. Chapoton: I would assume that. I would point out,  
16 Mr. Chairman, that there will be some revenue back, basically  
17 \$200 million over this three year period from this change,  
18 because you would be excluding this property from the ambit of  
19 the legislation.

20 Senator Bradley: Mr. Chairman, did we formerly have the  
21 depreciable life stated in law, or was that a ruling by the  
22 Treasury?

23 Mr. Leduc: It was not formerly a ruling. It was pursuant  
24 to rule-making authority in the Treasury as an alternative to  
25 a facts and circumstances depreciation regime. So, it was

1 elective for the taxpayer.

2 Senator Bradley: What has happened since then that would  
3 suddenly reduce the depreciable life of this asset?

4 Mr. Leduc: Senator, with the enactment of ACRS these rules  
5 have not been revised for approximately three years.

6 Additionally, hospital equipment is in a general professional  
7 service category. It is not in a limited or targeted category.  
8 And the industry advises that previously they did not rely on  
9 ADR lives but used facts and circumstances for their  
10 depreciation calculation.

11 So, it is not so much that there has been a significant  
12 change as that the elective ADR system was generally not used in  
13 this industry, according to the taxpayers.

14 Senator Bradley: Is that true prior to 1981? What was  
15 used?

16 Mr. Brockway: They used the facts and circumstances test,  
17 and I believe they took the position that the property's real  
18 life was roughly five years and they would depreciate on that  
19 basis using an accelerated depreciation method.

20 So, their claim is that on depreciation the enactment of  
21 ACRS did not benefit them above and beyond what they were  
22 depreciating it under before. They did not use the ADR class.

23 When you amended the law in 1981 you eliminated the  
24 possibility of using facts and circumstances.

25 Senator Bradley: They didn't benefit from the ACRS and

1 therefore they deserve to benefit by making this change, that  
2 is their argument?

3 Mr. Brockway: Well, basically they say that the way the  
4 legislation is drafted, the legislation says that you must use  
5 the ADR midpoint life, and in this case is this catchall  
6 category of nine years, and their property, the real economic  
7 useful life of that is not nine years, is only five years. That  
8 is the way they were depreciating it before and they need a  
9 special rule to treat them the same as most other taxpayers.  
10 That is the basic argument.

11 And this amendment would give Treasury the opportunity to  
12 look at this category of high tech medical equipment and  
13 decide whether they are right or not.

14 Senator Bradley: Fine.. Thank you.

15 Senator Bentsen: Their argument, I assume, is that the  
16 economic life is five years because of the very substantial  
17 changes that are taking place in the technology.

18 Mr. Brockway: That is correct, Senator.

19 The Chairman: Now I wonder if we might move to another  
20 area that I know ---

21 Senator Durenberger: Mr. Chairman, just to remind you, as  
22 long as we are going through things and as long as we are on  
23 the short lived property issue, I need to discuss at some time  
24 the whole issue of computers. They fall in the same category  
25 generally, although their life in some cases may be somewhat

1 different. But they fall in the same category as the  
2 discussion that just took place on hospital equipment. They  
3 got no benefit out of the ACRS changes and there is no revenue  
4 loss if we would give them a five year life, and I just want to  
5 alert you to the fact that I need the opportunity to try to work  
6 out something on the computer side, as well.

7 The Chairman: Okay. You have all been alerted.

8 Mr. Chapoton: Yes, sir. The problem in each of these  
9 cases is that the tax exempt leasing rule attempts to say we  
10 are going to apply economic life to the property that is leased  
11 to a tax exempt entity, and then they are coming back and  
12 saying -- and ADR is the proxy for that, ADR midpoint -- and  
13 they are coming back and saying, well, ADR midpoint was never  
14 right for us and we can show it because we didn't use ADR  
15 midpoint pre '81.

16 So, they are now coming back and saying, if you make us  
17 use it you are wrong because what you really want is economic  
18 life and we ought to be able to show what economic life is.

19 And the suggestion has been that we promulgate Treasury  
20 regulations as a substitute, a new ADR midpoint for these type  
21 of properties.

22 I think some type of provision is called for here in one  
23 of the provisions, such as we have suggested.

24 Senator Durenberger: The problem being that it seems to me  
25 that the bill that is before us affects the depreciation

1 treatment only in the case of the lease transaction. It doesn't  
2 if it is not a lease. And I can't argue with you on the life  
3 situation.

4 Mr. Leduc: May I clarify the 1564? As introduced, it  
5 contains a short lived property rule for property with an ADR  
6 midpoint of six years or less, which would include computers.

7 It limits the exception to property which is subject to a  
8 lease term of 75 percent or less of the ADR life.

9 So that the computers are in a slightly different  
10 situation than, for instance, the hospital equipment.

11 As I understand it, Senator, the sole issue with respect to  
12 computers is what term of lease ought to be permitted to be  
13 accepted from the bill.

14 Senator Durenberger: Maybe we can work that out.

15 Senator Packwood: Let's go on to real property next.

16 Mr. Leduc: Under the Senate bill, real property leases  
17 would be subject to the limitations on depreciation and also to  
18 the denial of the rehabilitation tax credit, if available, in  
19 the instances that the property is financed with tax exempt  
20 financing, in the event that there is a fixed purchase  
21 option in the tax exempt lessee, and in the event that there is  
22 a sale/lease-back of the real property, and finally in the event  
23 that the lease term exceeds ten years.

24 Senator Packwood: What effect does this have on the  
25 normal leasing provisions we find so frequently throughout the



1 United States of the government making leases on buildings,  
2 private buildings, and using them for public agencies?

3 Mr. Leduc: Senator, our information is imperfect on that  
4 question. It appears that a ten year trigger would sweep in  
5 certain ordinary commercial leases.

6 Senator Packwood: Why should it? What kind of abuses have  
7 we found that would justify doing that?

8 Senator Moynihan: I wonder if my friend from Oregon would  
9 let me make a remark to him before Mr. Leduc responds.

10 We have just this morning, in the Committee on Environment  
11 and Public Works, for about the fourth time passed out a Public  
12 Buildings Act, and it is a genuinely pressing concern of that  
13 committee that now just about half the space used by the Federal  
14 Government is leased, is rented, and the rental bill is now just  
15 approaching \$1 billion a year. And we can't get any response out  
16 of GSA or OMB on this matter.

17 And if we could get the Treasury in some way to explain why  
18 it might be a good idea to own your buildings and not lease  
19 them because of the tax system, we might have a better chance,  
20 and we would appreciate it.

21 It is a unanimous concern of the committee and a very  
22 frustrating one, because there are obviously people who like the  
23 present arrangements.

24 Senator Packwood: But there are two different questions,  
25 Pat. Maybe we want to go to a policy of owning all buildings,

1 I don't know. But to the extent that we don't, I am not sure  
2 that a normal lessor who happens to lease to the government  
3 should be put in an unfair position solely because of that.

4 And secondly, I am not sure with all buildings, and  
5 especially some in smaller towns, that you are going to be all  
6 that wise to go to all government owned buildings.

7 Senator Bentsen: We would like to go to about a 70/30  
8 ratio.

9 The Chairman: I think Treasury had some ---

10 Mr. Chapoton: I think the point here is -- it is a  
11 budgeting point again, primarily that the government lessee,  
12 where the government lessee is in substance the substantial  
13 owner of the building, ought to pay full rent for the building  
14 without regard to tax benefits. And that result would occur,  
15 for example, if you have a 100 percent building leased by the  
16 government for its full economic useful life. That is the  
17 clearest case, leased to a government agency.

18 Then, by denying accelerated depreciation to the lessor,  
19 you simply say, lessor, you will have to charge more rent to  
20 that government agency.

21 The tougher questions is when you have shorter term leases  
22 and less of the building used by government agencies.

23 So, I think if you start with the case, it is a 100 percent  
24 case, we are treating it incorrectly, then you have simply got to  
25 draw the line somewhere that you don't cover every little short

1 term lease and you don't cover one floor on a ten floor  
2 building is leased.

3 Senator Packwood: Is your only argument for shortening the  
4 time period that you want the rent to be raised? You want it to  
5 be reflected in rent, rather than depreciation?

6 Mr. Chapoton: That would be the only purpose. You want the  
7 economic cost to the lessee to be reflected in the rentals, that  
8 is correct.

9 Senator Packwood: That is a six of one, half a dozen of  
10 another argument. But apart from that, why should a lessor, a  
11 good faith lessor be treated any differently in their  
12 depreciation of the building simply because they happen to rent  
13 it to the government, as opposed to private enterprise?

14 Mr. Chapoton: This is the Navy leasing situation all over  
15 again. There is some inefficiency involved. But leasing will  
16 go on even if you have the rule I just described.

17 Senator Packwood: But that is the Navy leasing. You are  
18 talking about the ships?

19 Mr. Chapoton: Yes.

20 Senator Packwood: Well, it is a long way from post offices  
21 and normal contracts that lessors and the government have  
22 entered into for years, and I think it is unfair to use the  
23 Navy ship lease argument to undo what has been a relatively  
24 established, and to the best of my knowledge, a relatively  
25 unfraudulent situation.

1 Mr. Chapoton: Well, Senator, I think your analysis of it  
2 is correct. It is just the conclusion you reach, whether the  
3 full cost of the building should be borne by the agency. And  
4 in the argument that there is some inefficiency, if you encourage  
5 leases, which you do if you have -- which we do -- if you give  
6 faster depreciation to a taxable lessor, to a lessee government  
7 agency, then the government agency has some incentive to lease  
8 rather than to buy. It changes the economics.

9 Senator Bentsen: Would the Senator yield for a point?

10 Don't you have another difference in the Navy situation?  
11 Didn't you get into a sale/lease-back situation there?

12 Mr. Chapoton: No, sir. It was new vessels, as I understand  
13 it.

14 Senator Bentsen: It was not a sale/lease-back?

15 Mr. Chapoton: No, sir.

16 Senator Bentsen: Do you get a situation on these post  
17 offices where, insofar as the government is concerned, you end  
18 up, in effect, revenue neutral?

19 Mr. Chapoton: If the rental ---

20 Senator Bentsen: If you raise the rent, and if that is  
21 commensurate with the tax benefits otherwise?

22 Mr. Chapoton: If the tax benefit, 100 percent of the tax  
23 benefit is passed through to the government agency, then it  
24 would be revenue neutral. If there is any inefficiency in  
25 passing that benefit through to the government agency, the

1 government saves money by not giving the faster depreciation.

2 Senator Bradley: Well, is anyone implying that if this  
3 tax benefit is denied that post offices won't be built?

4 Mr. Chapoton: No, I don't think so, and I think post  
5 offices would still be leased.

6 Senator Bradley: To build the post office if you can  
7 lease it to the Federal Government, that is not a bad deal.

8 Senator Moynihan: Could I speak just to this? I don't  
9 want to prolong it, but I want to identify it.

10 The Chairman: I think it is one of the important areas.  
11 There is a real problem here.

12 Senator Moynihan: Yes. We have the problem, this is a  
13 serious concern of the Committee on Environment and Public  
14 works, and we have been having very little luck, bipartisan,  
15 five years at it.

16 The process of leasing began in the 1960's as a very simple  
17 way of avoiding the budgetary impact of buying a building, and  
18 we are not talking about the post office. We are talking about  
19 half those buildings on K Street that are all occupied by the  
20 government under 20 years leases and which people are taking  
21 off enormous profits, and we are ending up with nothing, and  
22 our rental bill is approaching a billion dollars.

23 Senator Packwood: Yes, but assuming the rent is fair --  
24 again, if you have got arguments about sweetheart deals or  
25 fraud, that is a different matter. But to the extent the rent

1 is fair, why should the owner or the lessor of the building  
2 receive a different treatment because he or she happens to  
3 rent all or part of the building to the government?

4 Senator Moynihan: I don't want to answer what I don't  
5 fully understand, but I think we now have an extra element to  
6 our inquiry. And I would like to say to the Treasury that we  
7 will be coming at you from the other committee to say, could  
8 you help us through some of the economic aspects of tax  
9 treatment with respect to this spreading problem of leasing,  
10 which is out of hand.

11 Mr. Chapoton: I would repeat, I think if the tax law were  
12 neutral, which it is not -- the tax law now gives the agency an  
13 incentive to lease, rather than to buy.

14 Senator Moynihan: Well, that is what I heard you say, and  
15 that keeps down the budget and so forth, but it ends up being  
16 paid in Treasury.

17 Mr. Chapoton: Correct.

18 Senator Moynihan: And it is just that kind of thing that  
19 we are running into, just that if you lease a building instead  
20 of building a building, that obviously helps your budget. And  
21 if you then have an additional tax break on the rent, again your  
22 budget has gone down but it all ends up costing the Treasury  
23 and maybe costing more than if we did in an open and aboveboard  
24 way.

25 Mr. Chapoton: That is correct, and to repeat, to the

1 extent the tax benefit to the lessor is not 100 percent passed  
2 through to the lessee government agency, then we have some  
3 inefficiency in the overall sense.

4 Senator Packwood: With respect to relative inefficiencies,  
5 we are all aware of it by personal experiences. I have had to  
6 move my Senate office in Portland from the building we were in,  
7 which was a government building, because there was going to be  
8 some renovation and rebuilding. That space we were leaving.  
9 So, we had a choice to go to another government building, a  
10 relatively new one, or to rent private space.

11 And, of course, whichever way we go, if we go to the  
12 other government building there is an internal government  
13 allocation against our allotment for space. We could have gone  
14 to the private space cheaper, roughly equivalent in size. You  
15 can argue about location. We could have gone to the private  
16 space cheaper, except, of course, we would have been paying  
17 money out to the private sector rather than interallocating  
18 it among the government.

19 And I am not impressed with the argument that the Federal  
20 Government runs buildings any more efficiently than they run  
21 most things.

22 Mr. Chapoton: Senator, I won't argue one side or the  
23 other of that argument, but I think it remains that it would not  
24 be surprising that it would be cheaper because a part of the  
25 rent is then paid through the tax system. Part of the rent is

1 paid by the lessor enjoying a tax benefit that the Federal  
2 Government obviously doesn't enjoy if it owns its own  
3 building.

4 But I would emphasize, even if you made that neutral, there  
5 will be plenty of cases where leasing is preferable to buying,  
6 because the government agency doesn't know how long it will be  
7 there or it is a budgeting -- one of the problems with buying  
8 is it all goes in your budget in one year, when the use may be  
9 for 20 or 25 years.

10 So, leasing is closer to correct budgeting.

11 Senator Packwood: All I am saying -- and Mr. Chairman, I  
12 feel strongly enough about this to make the point once more  
13 today -- that I do not think a lessor should be placed in a  
14 different position solely because they lease all or part of  
15 their building to the Federal Government.

16 The Chairman: Senator Long.

17 Senator Long: I was just looking at this thing from the  
18 point of complexity. Now, it seems to me, as far as cost is  
19 concerned, generally speaking if the government builds a  
20 building in the long run it would save the government money. I  
21 think we can agree on that. If the government builds a building  
22 for itself, in the long run it is cheaper for the government to  
23 own the building.

24 Mr. Chapoton: Senator, I don't know that I am qualified to  
25 say that. I think people argue that, but that is not really my



1 point.

2 Senator Long: Well, as I understand it now, we are not  
3 talking about really whether it is cheaper or not, that the  
4 government is going to save money in all this, because  
5 obviously the government gets the building cheaper if the  
6 lessor gets the tax benefit.

7 Mr. Chapoton: Correct.

8 Senator Long: All right. So, if you take away the tax  
9 benefits, the government pays more in one respect but it collects  
10 more in taxes on the other hand. So, it looks to me as though it  
11 is a kind of a wash in that regard. Okay?

12 Mr. Chapoton: Correct.

13 Senator Long: Now, I am looking at the item of complexity.  
14 It seems to me that where people are leasing buildings to the  
15 government, and let's assume that they do more than just one  
16 transaction -- some folks do lease quite a bit of property to  
17 the government, I understand.

18 Now, if he is leasing it under the present law, you would  
19 think that the price he is getting from the government is about  
20 the same as the price he would get from anybody else. And the  
21 way he keeps his books would be the same as he keeps his books  
22 when he is doing business with anybody else.

23 Now, if it is not going to make any money for the  
24 government on the overall, it seems to me that you are just adding  
25 a lot of complexity to say that you have got to keep your books

1 one way if you are leasing to the government, and you have got  
2 to keep your books a different way if you are leasing to a  
3 private individual.

4 And if it is not gaining us anything, I don't know why  
5 add the complexity to the code.

6 Now, I can understand that we don't want somebody leasing  
7 the city hall. That is an area where ---

8 Mr. Chapoton: That is a different question, though. I  
9 agree.

10 Senator Long: That is a different matter. There the city  
11 government is solving one of its problems by increasing the  
12 problems of the Federal Government. That is a different matter.

13 But it seems to me that where he is leasing to the Federal  
14 Government, I don't know why we would want to add that  
15 additional complexity to the code, Mr. Chapoton. That is the  
16 question.

17 Mr. Chapoton: Well, I am not sure how much complexity,  
18 Senator, particularly if you draw the lines clearly, and that I  
19 agree should be done and perhaps was not done well enough in  
20 the House side.

21 But the fact remains, if you don't do this, we do have an  
22 incentive for agencies to lease rather than to buy, and that is  
23 the concern, misbudgeting.

24 Senator Moynihan: Mr. Chairman, if I could just say to  
25 Mr. Chapoton, who quite correctly declined to offer a view on

1 something he has not mastered, there is a CBO study that argues  
2 that in almost all circumstances a purchase is more efficient  
3 than leasing where there is a substantial amount of space, where  
4 there is a building needed, as against where you need a floor  
5 in a small town. That CBO study is done and it does exist.

6 The Chairman: Senator, there are lots of kinds of property  
7 involved here, also. I know Senator Warner has called it to  
8 my attention. If you look across the river, you will see a lot  
9 of buildings over there that are occupied by federal tenants.  
10 And so he has an interest in this, as others do.

11 Again, we have raised it and we are trying to figure out  
12 some way to come to a reasonable compromise, I guess is the  
13 word, if it is something that Treasury could live with and  
14 something that those who have a direct interest can live with.  
15 Senator Packwood has spoken to me about it. It is going to take  
16 a little time to work it out.

17 Now, there have been a lot of ideas floated around how you  
18 might address the problem, depending on the length of the term  
19 of the lease, how much of the space was occupied by the tenant,  
20 and those factors, I think, are important.

21 I had the same question that maybe Senator Long has. I  
22 don't know how you determine -- maybe it is not that  
23 difficult -- whether it is 50 percent or 30 percent of the space,  
24 just send somebody out there to measure from time to time.

25 But I think we have raised this, and if we could just go on

1 for a few minutes and take up the Army, Navy and Air Force ---  
2 Senator Bradley: Mr. Chairman, I must say, I have been  
3 alerted to so many government buildings in the last couple of  
4 days that I didn't realize. I kind of get the impression that  
5 the people who have been calling me believe the Federal  
6 Government is the problem unless it is the lessee. And I hope  
7 that we are going to be sensitive to that.

8 The Chairman: The government still owns the Capitol, right?  
9 (Laughter.)

10 Mr. Chapoton: As of this morning, yes, sir.

11 The Chairman: There are a lot of people who would like to  
12 buy it and close it.

13 (Laughter.)

14 The Chairman: I guess we are also leasing the Armed  
15 Forces. I don't know who owns them.

16 Senator Moynihan: Mr. Chairman, I don't want to get  
17 involved in too many extraneous matters, but as a matter of fact  
18 we are leasing the Armed Services.

19 Again from the Public Works Committee, this year the  
20 United States Corps of Engineers is doing more work in Saudi  
21 Arabia than it is doing in the United States. We have leased  
22 out the Corps of Engineers to the Arabs.

23 The Chairman: Who is the expert on the Navy? Senator  
24 Chafee, former Secretary of the Navy, is here.

25 Senator Chafee: Well, Mr. Chairman, I am prepared to

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1 address that matter if you ---

2 The Chairman: I thought I would have the staff explain  
3 it briefly.

4 Senator Chafee: Great. Fine.

5 The Chairman: We would like to touch on trade adjustment  
6 assistance before we leave at noon. We are not going to meet  
7 this afternoon. There are going to be some amendments, I  
8 understand.

9 Mr. Leduc: We are aware of a number of Department of  
10 Defense leasing transactions which are at various stages. The  
11 Navy is underway on procurement of some ships, the TAKX ships  
12 for the Rapid Deployment Force, and the T-5 tanker program.  
13 Those ships are to be provided under their terms under a service  
14 contract for extended periods.

15 Under the terms of the deal, the Navy believes that the  
16 investment credit will be available despite the fact that these  
17 are long term transactions and these are service contracts and  
18 have so indemnified the private parties.

19 Similarly, there are some Air Force lease/procurement  
20 transactions, two in particular of which we are aware, which are  
21 underway.

22 There is no special rule relating to Department of Defense  
23 leasing in the bill as introduced. However, under the general  
24 restrictions relating to government leasing and the generally  
25 effective dates, the Navy procurement programs would be subject

1 to the bill because the ships will not be delivered this year,  
2 and accordingly the investment credit and the accelerated  
3 depreciation deductions would not be available.

4 The Chairman: I guess generally that decision -- there were  
5 House and Senate bills introduced which had a May 23rd effective  
6 date, and the ship matter was debated on the last -- what was  
7 it, a continuing resolution or whatever.

8 Mr. Leduc: And on the Department of Defense Appropriations  
9 Bill, Senator.

10 The Chairman: Did that just temporarily resolve the  
11 problem?

12 Mr. Leduc: Those amendments did not go to the underlying  
13 substantive tax questions, Mr. Chairman, which were not discussed,  
14 to my knowledge, in that debate.

15 Senator Bentsen: Mr. Chairman, if I might just comment a  
16 moment, I have historically tried to oppose those things that  
17 change the rules after a deal is made, and I would have some  
18 concern for a provision that required them to have been in use  
19 when a contract, a binding contract had been made and there was  
20 no possibility of having the ships completed in the period of  
21 time necessary to get them in use by that period of time.

22 And in the matter of changing the rules there, and I am  
23 sympathetic to changing the rules, but to do it without giving  
24 some kind of consideration for the problem created, I would like  
25 that to be done.

1           The Chairman: I think that is a matter that we have  
2 discussed. I mean, it seems to me if there was reliance on a  
3 certain standard and then we changed the standard, I think we  
4 have a problem.

5           Senator Long: We have a situation at New Orleans where a  
6 ship being built, and under the House bill they would be  
7 protected, apparently, but apparently the language under the  
8 Senate bill would put them in jeopardy.

9           I was saying, Mr. Chairman, that we have a ship being built  
10 in New Orleans that is involved here, and under the House  
11 language they would be protected, grandfathered in, you might  
12 say, and under the Senate bill they would not be.

13           And I would hope that we would use the language of the  
14 House bill in that regard, that when the people bid on the  
15 contract and all that, they bid based on the law as it was at the  
16 time. And I would think that that is traditionally how we do  
17 things on the Committee, that if someone made a bid and his  
18 bid has been accepted and he is performing on his contract,  
19 he shouldn't be adversely affected retroactively. And I would  
20 hope that we could protect that situation.

21           The Chairman: We might hear from Treasury on that.

22           Mr. Chapoton: Senator, I am sorry. We were conferring. I  
23 didn't get the ---

24           Senator Long: Well, there is a difference between the  
25 language in the Senate bill and the House bill, and applying that

1 to a situation in New Orleans where a ship is being built  
2 under the existing law.

3 Now, they would be adversely affected if they are not  
4 grandfathered in, and all I am saying is that we ought to use  
5 the language of the House bill for that particular point just  
6 because it is not quite fair to adversely affect people who are  
7 performing on a contract where the contractor bid under the law  
8 as of that time.

9 And I would hope that we would grandfather it in like the  
10 House bill would do it.

11 Mr. Chapoton: Would this be leased to the government?

12 Senator Long: Yes, the ship is being leased to the  
13 government. But the point is that the House grandfathered it  
14 in. It is a Navy ship.

15 All I am saying is, Mr. Chapoton, that the contract,  
16 everything involved here, the contracts were made and the work  
17 was undertaken so the work is in progress, and all this happens  
18 prior to our action, and therefore it would seem to me that  
19 that situation should be protected as the House bill has done.

20 Mr. Chapoton: Well, I think in the case of a government  
21 lease, the House bill caused a problem that it had to be placed  
22 in service -- it has changed -- okay, that was dropped out.

23 It originally had to be placed in service prior to the end  
24 of this year. We objected to that, and that is right, the  
25 House did drop that provision.



1 So, I would assume that would cover the situation you are  
2 describing.

3 Mr. Brockway: Both bills, as introduced, would have -- the  
4 general effective date, if it applied, it would have exempted  
5 these transactions because there is a binding contact in effect  
6 before May 23rd, the date of introduction.

7 However, there was a special rule in both introduced bills  
8 that did not apply to government lessee situations, basically the  
9 Navy transaction, if the property wasn't placed in service by the  
10 end of this year.

11 So, under both introduced bills, that transaction would  
12 have been affected.

13 The House deleted that provision in the mark-up, but it is  
14 still in the Senate bill.

15 The net effect of this, if I understand the transaction, is  
16 that in the contracts there is an indemnity clause for change of  
17 the statute to take away the tax benefits, so that in the end  
18 the Federal Government, I think, if you enacted this legislation  
19 without exempting it, the Federal Government would have to  
20 indemnify the lessor under that transaction, if I understand the  
21 way it works.

22 Senator Long: Well, I would hope that we don't have to  
23 get involved in all that. It would be no gain or loss to the  
24 government. But I would hope that we could just leave that  
25 transaction the same as the House did.

1 Mr. Chapoton: We thought there should be no special  
2 placed-in-service rule applicable to government property. I  
3 believe that is what you are saying, Senator.

4 Senator Long: Yes. I am suggesting that that is how we  
5 do it, then.

6 The Chairman: I think that is an area that we will have to  
7 work on.

8 Could I just say before anyone leaves, we would like to  
9 maybe have a little bit more discussion and just discuss  
10 briefly the trade adjustment assistance problem, and I would  
11 also indicate to members, if you don't otherwise have  
12 breakfast plans tomorrow morning, we have one of our breakfast  
13 meetings with the Finance Committee members with the  
14 pharmaceutical industry starting at 8:00, and we adjourn  
15 promptly at 9:15. So, if you can be here, we would appreciate  
16 it.

17 Senator Chafee.

18 Senator Chafee: Mr. Chairman, I think the point has been  
19 well made here and I hope our case has been won. Basically,  
20 what we are saying, the Navy is saying and I support that  
21 position, is a binding contract was entered and we shouldn't  
22 be penalized by this placed-in-service, and therefore, under  
23 both of these contracts, the TAKX and the tankers, they could  
24 go ahead with them.

25 Is that agreeable to the Administration?

1 Mr. Chapoton: Senator, I am never quite sure of the  
2 specific facts of a particular case. What we are saying is  
3 that a special placed-in-service rule should not apply to  
4 government property, and I believe that is correct. If that  
5 is removed, as it was in the House, then those contracts would  
6 fit within or be grandfathered under the bill.

7 Senator Chafee: Mr. Chairman, I will quit while I am ahead.

8 The Chairman: Right. I think that is like everything  
9 else, it is still -- there is a \$400 million revenue loss. We  
10 don't want to lose sight of that. So, maybe \$400 million when  
11 you have got big deficits and a Treasury study saying they don't  
12 make any difference is no problem for Treasury, but it is  
13 something that we would like to not accept at this point.

14 I wonder if we might now -- I know there are a number of  
15 members who want to get into trade adjustment assistance. We  
16 will meet again tomorrow morning at 10:30 and we will pick up  
17 where we left off.

18 Senator Boren: Mr. Chairman, I hope the Treasury will  
19 really try to look at this co-op problem again, because I think  
20 there is strong agreement on the Committee about it, and I  
21 think that side has shown some willingness to compromise on it  
22 and I think that all might be lost from the Treasury point of  
23 view if we don't try to find some accommodation on this.

24 Mr. Chapoton: We will look at it, Senator.

25 The Chairman: Thank you.

1 (Recess.)

2 The Chairman: Are we ready to discuss -- I know a number  
3 of members have an interest in, on both sides, trade adjustment  
4 assistance. I know the Administration is opposed to any  
5 extension. I think the House added \$400 million.

6 Is the Labor Department represented?

7 Senator Bradley: Mr. Chairman, what happened to all the  
8 people?

9 The Chairman: Let me say before I yield to Senator  
10 Danforth along with Senator Moynihan and others who wanted just  
11 to bring this up at the earliest possible time, that there has  
12 been an effort by the Labor Department -- their position is  
13 against any extension, but at least they have been helping us  
14 with numbers. And so, we have had a little discussion going on  
15 in a separate room to see if we could ratchet down the cost of  
16 this program and somehow justify it.

17 I mean, it is pretty hard to justify this program when you  
18 look at who benefits and why they benefit. But so far, I don't  
19 know whether they have reached any agreement, but we probably  
20 might discuss it for a few moments and continue to see if we  
21 can't hammer out something this afternoon.

22 Senator Danforth.

23 Senator Danforth: Mr. Chairman, the situation is as  
24 follows:

25 The Trade Adjustment Assistance Program will expire on

1 Friday if it is not extended by the Congress and signed into law  
2 by the President.

3 We have provided in the budget money for the extension of  
4 trade adjustment assistance.

5 The House has passed a bill which provides certain changes  
6 from the present Trade Adjustment Assistance Program, extending  
7 coverage to secondary suppliers and requiring that the  
8 Secretary of Labor approve retraining funds rather than giving  
9 him discretion to do so, and further, making the retraining  
10 allowance and supplemental compensation provisions retroactive  
11 to September 30, 1982.

12 As a result of those changes by the House, the dollars in  
13 the House program are higher than was anticipated when the  
14 budget resolution was passed, and therefore there have been  
15 really two basic questions before us; how to reconstitute the  
16 program in a way that makes sense and yet reduces the number of  
17 dollars from the House proposal to something that could get  
18 through the Finance Committee and through the Senate and be  
19 signed by the President; and secondly, getting the bill passed  
20 and signed sometime between now and Friday night.

21 So, there has been a staff meeting that has been going on  
22 this morning, and I think Mr. Kassinger is prepared to discuss  
23 what the proposal that the staff has will be.

24 The Chairman: Could I ask, before calling on Ted here,  
25 briefly, from the Administration, who is ---

1 Senator Moynihan: Mr. Chairman, could I make just one  
2 remark . We are shifting our situation here.

3 We are no longer talking about entitlements and outlays  
4 under the reconciliation instruction. We are now talking about  
5 a simple authorization that does not in any way affect our  
6 reconciliation situation.

7 The Chairman: Okay. Do you want to give the  
8 Administration's position and why, and the reasons therefor?

9 Ms. Mantho: Certainly, Mr. Chairman.

10 The Chairman: Get the mike real close.

11 Ms. Mantho: We are not proposing any reauthorization of  
12 trade because of the new Job Training Partnership Act. Title III  
13 of that bill is for dislocated workers. Trade eligible people  
14 now will be eligible under that program.

15 We have asked for in '84 \$223 million, some of which must  
16 be matched by the states, which represents really ten times  
17 what has ever been spent for training under the Trade  
18 Adjustment Program.

19 The state matches depend on unemployment levels in the  
20 states. Michigan, for example, and West Virginia will not have  
21 to match any money at all. They will get their allotment without  
22 having to come up with any state funds.

23 In other cases, the matches, you know, are lower. They are  
24 not 50 percent in every case. And the states may use  
25 unemployment benefits to count towards those matches.

1           And we feel this is a generous program and it is a matter  
2 of equity. If you are unemployed, you are unemployed, and we  
3 don't think we should be treating people any differently.

4           The Chairman: What about some of the states in the past  
5 several years -- I mean, I have got a table in front of me saying  
6 that in eight years it helped 700 people in Oklahoma.

7           Ms. Mantho: That is true.

8           The Chairman: Seven thousand, I guess, in Kansas. I mean,  
9 is there anything in this proposal that may be pending that  
10 is going to do more for anyone?

11           Ms. Mantho: Not to my understanding, Senator Dole. I  
12 think what you see when you look at the state breakdowns is  
13 that there are going to be certain states with certain  
14 industries that would be covered and eligible under this  
15 program. But a lot of other states that are experiencing  
16 fairly high levels of unemployment do not have industries that  
17 are determined to have been affected by imports, in which case  
18 those individuals who are unemployed would not be eligible under  
19 the trade program.

20           And under the dislocated worker title in JTPA, they would  
21 all be eligible for retraining.

22           And what we have done, too, which is a departure from the  
23 past, is that if they are in Job Training Partnership Act  
24 training, that will constitute state approved training, which  
25 means they may continue to receive their unemployment

1 compensation benefits.

2 In the past it was up to the states and most of them were  
3 very conservative about what sort of training they approved.  
4 And what we saw happening was, when someone entered training  
5 they were denied unemployment.

6 JTPA overrides those state laws and if they are in  
7 training they may continue to receive unemployment benefits,  
8 and that would include the FSC benefits.

9 The Chairman: Ted, can you tell us what Danforth,  
10 Moynihan and others proposed?

11 Mr. Kassinger: Yes, Mr. Chairman.

12 The Chairman: How does it work and how can you justify it?

13 Mr. Kassinger: As a preliminary note, let me note what the  
14 principal provisions of the House bill are.

15 The House bill would reauthorize the program for two years  
16 and expand it in a couple of ways, and these are things that  
17 Senator Danforth is addressing in his proposed compromise.

18 First, the House bill would expand the provisions of the  
19 current program to cover workers who are in independent firms  
20 supplying essentially parts and services to products that are  
21 directly impacted by imports.

22 Secondly, it would expand ---

23 Senator Danforth: In other words, it would apply, for  
24 example, maybe to the tire industry as well as the auto  
25 industry. Right?



1 Mr. Kassinger: That is correct, Senator Danforth.

2 The second area of expanded coverage in the House bill is  
3 that it would extend eligibility to workers laid off or  
4 threatened to be laid off by reason of the relocation of their  
5 firm overseas.

6 The House bill further requires the Secretary of Labor to  
7 approve training if certain conditions are met. The current law  
8 makes that authority discretionary.

9 And further, the House bill would provide \$15 per day in  
10 supplemental assistance to workers in training who are not  
11 eligible for readjustment allowances.

12 Some of these provisions of the House bill are retroactive.

13 Senator Danforth proposes, as I understand it, to renew the  
14 existing authority of the bill for two years, as does the  
15 House. He would not make the provisions of the House bill that  
16 are retroactive in fact retroactive. It would be a prospective  
17 program only.

18 He would not include the secondary workers in the first  
19 year, but would in the second year of the authorization, and he  
20 would include the provision of the House bill that mandates  
21 approval of training if the conditions are met.

22 The Chairman: What is the cost authorization?

23 Mr. Kassinger: We have disparate numbers, Mr. Chairman.  
24 The Department of Labor estimates that for fiscal year '84 the  
25 authorization would need to be \$253 million. According to the

1 CBO, it would be \$200 million. I am sorry. The CBO number is  
2 \$152 million, the Department of Labor is \$200 million.

3 Senator Danforth: The budget was 162.

4 Mr. Kassinger: The budget resolution doesn't contain a  
5 specific provision.

6 The Chairman: There is nothing in the budget. The  
7 President's budget had zero.

8 Senator Bradley: But the Senate budget resolution did  
9 provide for, through a crosswalk, about \$132 million.

10 Senator Danforth: What is the 162?

11 Mr. Kassinger: I believe that is 132 plus the firm  
12 program of about 30.

13 Senator Bradley: That comes to 162.

14 Mr. Kassinger: That is right. The numbers I gave you,  
15 Mr. Chairman, included reauthorization of the firm program in  
16 essentially its same form.

17 Senator Chafee: Well, the Senator Danforth program, then,  
18 would be less, I presume.

19 Mr. Kassinger: According to the Department of Labor, it  
20 would be 200.

21 The Chairman: For a year. The second year goes up, as I  
22 understand it.

23 Senator Long: Mr. Chairman.

24 The Chairman: Senator Long, if we can get this worked out,  
25 has a suggestion.

1 Senator Long: I would like to suggest one modification to  
2 this, which I can support this proposal but I would like to  
3 suggest a modification which I think would make it better.

4 I would like to suggest that we include a provision that  
5 the adjustment assistance provided for firms would provide a  
6 preference for employee stock ownership companies for these  
7 reasons:

8 One, that these distressed companies with employee stock  
9 ownership plans show a very high survival rate, higher than  
10 ordinarily.

11 For example, the researchers indicate that of approximately  
12 60 employee buyouts in the last five years, only five of them  
13 have failed.

14 Second, the employee stock ownership type financing raises  
15 the likelihood that such loans would be repaid because the  
16 principal payments on ESOP loans can be deducted if the  
17 employees own as much as 25 percent of the stock, and I would  
18 suggest that that would be the ratio we will look at.

19 And this would mean that distressed firms need not generate  
20 as much revenue to service their debt.

21 I note that of 329 direct loans made under the current  
22 program, 112 have been written off at a cost of \$60.8 million  
23 before the Committee tightened up on the program in 1981. Even  
24 now, 58 percent of the loans are in default, liquidation, and  
25 require special servicing.

1 An ESOP provision would continue the Committee policy of  
2 raising the likelihood that these loans would be repaid.

3 In the third place, equity suggests that where taxpayers'  
4 funds are used to assist a private company, there should be a  
5 preference for companies willing to share the benefit with the  
6 assistance, their employees. In other words, this doesn't say  
7 that they must have an employee stock ownership plan, but you  
8 would prefer the firm that does.

9 And I would point out that when we put through the  
10 Chrysler Bill, we put a provision in there for employee stock  
11 ownership and it has worked out extremely well. It raised  
12 morale, increased productivity, and worked very well indeed.

13 I just think it is good policy that where we put government  
14 money or government credit in the helping of a private company  
15 to make it, that the employees should participate in the  
16 benefit if it succeeds.

17 Senator Heinz: Mr. Chairman, I think Senator Long's  
18 proposal makes a good deal of sense. It seems to me there is  
19 nothing wrong with giving a priority consideration here to  
20 companies with ESOP's.

21 Just before we go any further, I want to be sure that I  
22 understand what we do have in here for firms.

23 Are we retaining the present program for firms?

24 Mr. Kassinger: As I understand the proposal, it would  
25 retain essentially the same program for the firms. Now, the

1 House bill has one minor difference. It raises the amount  
2 allowable for industrywide technical assistance to \$10 million  
3 from \$2 million.

4 Senator Heinz: Mr. Chairman, I want to commend the  
5 Committee for doing that, because there is no doubt that in the  
6 late 70's there were abuses in the program. A lot of unnecessary  
7 loan guarantees were granted. That is not now the case with the  
8 firm program.

9 Indeed, the firm program has proven to be -- according to  
10 the statistics I have, which I would be happy to share with any  
11 member of the Committee -- to be an extremely cost effective  
12 program of keeping firms open and people employed, paying taxes,  
13 rather than have them go onto unemployment comp or, for that  
14 matter, trade adjustment assistance.

15 The firm component is now mainly technical assistance and  
16 it looks extremely cost effective.

17 The Chairman: Go ahead.

18 Senator Chafee: I had a couple of questions.

19 The Chairman: I was just going to ask to be put in the  
20 record this list of the states and the cases certified and the  
21 workers receiving -- obviously, some states have benefitted a  
22 great deal. Others, like Alaska, they have qualified two people  
23 in eight years, Nebraska one, North Dakota one. They are  
24 probably not too anxious for this program. The District of  
25 Columbia, six; Idaho, 450.

1 And again, I am not suggesting that the Administration is  
2 going to change its mind, but what I would like to do, if it is  
3 satisfactory, is to see if we can reach some agreement, even with  
4 the Administration, this afternoon. I can visit with Mr. Stockman  
5 and see. If we can reach some agreement, we can act rather  
6 quickly.

7 I understand the House bill is here.

8 Senator Moynihan: Mr. Chairman, could I make two points?  
9 First is, there are plenty of states that would trade the  
10 agricultural subsidies for the Trade Adjustment Act any day.

11 But secondly, just a matter of to be precise, the Budget  
12 Committee anticipated that there would be trade adjustment  
13 assistance reauthorized this year. It comes under Section 600,  
14 Income Security.

15 In the crosswalk, as Senator Bradley observed, there is a  
16 figure of \$132 million. That is an informal estimate by budget  
17 staff about how you are going to break this thing up between  
18 committees.

19 But it is a precise understanding of the budget resolution  
20 that there will be this legislation in some amount.

21 Senator Chafee: Well, they also estimated a little  
22 revenue that we haven't raised, too, I suspect, in the Budget  
23 Committee.

24 Senator Moynihan: One subject at a time.

25 Senator Chafee: Mr. Chairman, I would like to ask a couple

1 of questions, if I might.

2 In the legislation, the legislation as I understand it  
3 divides up into two parts -- the employer, I guess that is  
4 what Senator Heinz refers to as the firm.

5 Mr. Kassinger: The firm program.

6 Senator Chafee: And the employee. Now, do you keep the  
7 firm part, the employer part -- Senator Heinz indicates that  
8 that is reduced to technical assistance. But it has included  
9 in the past, hasn't it, loans? And what does the House bill  
10 do on that?

11 Mr. Kassinger: The firm program currently offers direct  
12 loans, loan guarantees, all under the rubric of financial  
13 assistance, and technical assistance.

14 The program, as I understand it, for last year spent  
15 roughly half of its funds on technical assistance and half on  
16 direct loans and guarantees. It was a pretty even split, \$13  
17 million both ways.

18 The House bill would simply continue ---

19 Senator Chafee: \$13 million apiece?

20 Mr. Kassinger: Roughly, very roughly.

21 The House bill would simply continue the existing  
22 authorization.

23 Senator Chafee: Which means what?

24 Mr. Kassinger: \$28 million.

25 Senator Chafee: Okay. And then you get to the employee

1 part. Now, we passed a couple of years ago legislation saying  
2 that the employee must first, what, exhaust his unemployment  
3 compensation benefits.

4 Now, of course, we have extended those based on the  
5 legislation we just passed the other day. But that only goes  
6 to certain states that have the unemployment levels, doesn't it?

7 Mr. Lang: Trade adjustment assistance is a separate  
8 program that comes after unemployment insurance, extended  
9 benefits, FSC, everything else.

10 Senator Chafee: Yes, I appreciate that. But what I am  
11 point out is, you could have a trade adjustment assistance  
12 requirement in a state where they haven't had the extended  
13 unemployment compensation.

14 Mr. Kassinger: That is correct.

15 Senator Chafee: So that we have to be careful in saying  
16 that under the extension of the unemployment compensation it  
17 now gets up to the maximum, I guess, in about 61 weeks. So, you  
18 are not saying that somebody who gets trade adjustment  
19 assistance would get it on top of 61 weeks. He might well be  
20 in a state where they only get the 26 weeks.

21 Mr. Kassinger: That is right.

22 Mr. Lang: There are two basic limitations, Senator. The  
23 first is that no more than 52 weeks of everything combined can  
24 be received. That is what you did in '81. And second, following  
25 the expiration of the basic unemployment insurance benefit, the



1 trade adjustment benefit has to be received in not more than  
2 52 continuous weeks, so that people can't continue to receive  
3 trade adjustment assistance indefinitely.

4 The effect is to postpone trade adjustment assistance until  
5 after all combined benefits, but in any event not to give you  
6 more than 52 weeks of benefit.

7 Senator Chafee: So, therefore, based on the extension of  
8 the unemployment comp we passed, you could have a situation  
9 where somebody had lost their job due to imports, went on  
10 unemployment comp, stayed on unemployment comp to 52 weeks, then  
11 would say, now I am applying for trade adjustment assistance and  
12 the answer would be, no, you can't get it because you have gotten  
13 your 52 weeks under your unemployment comp.

14 Mr. Kassinger: Actually, I think they would be entitled to  
15 26 weeks additional benefits if they are involved in a training  
16 program.

17 Senator Chafee: That is a separate kettle of fish. Then  
18 they could go on to a training program for an additional 62  
19 weeks.

20 These statistics here that the Chairman has, do they deal  
21 with the number of people who have qualified for the benefits  
22 per state? Is that what this paper is?

23 Mr. DeArment: It is a cumulative figure of the number of  
24 workers who have received trade adjustment assistance from  
25 April, 1975 through August, 1983.

1 Senator Chafee: Would it not be true that with the  
2 extension of the employment comp those who draw on this would  
3 be substantially reduced, those who qualify for the trade  
4 adjustment assistance? I would think, because probably those  
5 states that have the extension are the very states where you  
6 have got import problems.

7 Senator Bradley: If the Senator would yield. That isn't  
8 always the case.

9 Senator Chafee: Not always. I appreciate that.

10 Senator Bradley: New Jersey, for example, our unemployment  
11 rate is lower than other states that have been hard hit by  
12 imports and yet we have had 47,000 people take advantage of  
13 this program over the last decade.

14 Senator Chafee: Now, the Administration says, at least in  
15 one editorial I saw, I guess, from the Post, indicates that those  
16 unemployed qualifying for this don't go into the training  
17 programs. Is that right? At least the editorial indicated  
18 four percent. I don't know whether it is accurate or not. It  
19 was in the Post. Only three percent enrolled in retraining  
20 and less than half of those completed it.

21 I have had some experience with retraining programs and I  
22 wouldn't question that only half complete it.

23 Do you know anything about that?

24 Mr. Fooks: Mr. Chafee, that experience is an accurate --  
25 that data is an accurate reflection of the experience prior to

1 1981.

2 I think under the present Administration more money has been  
3 provided for training, \$25 million in '81 and roughly \$37 million  
4 this year. And as far as I know it has all been obligation and  
5 being used.

6 So, I think more people are getting into training and the  
7 training experience is better. But it is still a small  
8 minority of the eligibles entering and taking advantage of  
9 training.

10 The Chairman: Could I suggest, because I have another  
11 commitment -- the House bill is in the Committee, we have  
12 actually had no hearings on it on our side. I know there is a  
13 lot of interest in trying to get it done.

14 So, if there is no objection, what we will do is have  
15 informal discussions through the afternoon to see if we can work  
16 out some agreement that would satisfy the Committee.

17 I know it is not going to satisfy the Administration, and  
18 keeping that in mind we are going to have to ---

19 Senator Moynihan: Mr. Chairman, could I just say, we had  
20 hearings in March.

21 Senator Danforth: Yes, we had a hearing on trade  
22 adjustment assistance.

23 The Chairman: Well, none since we got this very expansive  
24 House bill over here that does everything, as they normally do,  
25 opens all the gates and all the doors and don't worry about the

1 cost.

2 So, let's see if we can figure out something that the  
3 Administration might swallow. If it is small enough, they might  
4 swallow it.

5 Senator Danforth: Mr. Chairman.

6 The Chairman: Yes.

7 Senator Danforth: I am concerned that it is going to be  
8 difficult to work anything out this afternoon. Maybe it is  
9 possible, and I think it is worth pursuing, but it may be  
10 difficult to accomplish.

11 I wonder if the Committee could agree in principal that ---

12 The Chairman: We are going to meet again tomorrow  
13 morning. We can't act on it today. We have got the War Powers  
14 Act today. And all day tomorrow, if we can't agree -- I would  
15 rather try to work it out. If we can't work it out, then we  
16 can agree in whatever way we want tomorrow morning.

17 Also, we haven't had any time to check the proposal by  
18 Senator Long on ESOP's.

19 It seems to me there would be nothing lost by trying to  
20 see what we can accomplish.

21 If we can't accomplish it, then tomorrow morning we will  
22 break it up and vote on it.

23 Is that all right?

24 Okay. Then we will meet again at 10:30 in the morning, and  
25 I might ask the Labor people if they would be willing to work

1 out some schedule this afternoon where you could sit down with.  
2 different staff people. Now, I know you can't get involved  
3 in supporting anything, but it would be helpful if you could  
4 furnish us numbers and suggestions.

5 Ms. Mantho: Yes, we will be happy to.

6 The Chairman: Thank you. We are adjourned.

7 [Whereupon, at 12:25 p.m., the Committee recessed, to  
8 reconvene at 10:30 a. m., Thursday, September 29, 1983.]  
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