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1 EXECUTIVE SESSION ON NOMINATION OF ROBERT KIMMITT TO BE
2 GENERAL COUNSEL OF THE TREASURY DEPARTMENT; SIMPLIFICATION
3 OF IMPUTED INTEREST RULES (H.R. 2475)

4 THURSDAY, JUNE 6, 1985

5 U.S. Senate

6 Committee on Finance

7 Washington, D.C.

8 The committee met, pursuant to notice, at 9:37 a.m. in
9 room SD-215, Dirksen Senate Office Building, the Honorable
10 Bob Packwood (chairman) presiding.

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

14 Also present: Mr. William Diefenderfer, Chief of Staff;
15 Ms. Susan Courter, Professional Staff member; Mr. Mikel
16 Rollyson, Staff Legislative Counsel, Department of the
17 Treasury; Roger Mentz, Deputy Assistant Secretary for Tax
18 Policy, Department of the Treasury; Mr. Michael Stern,
19 Minority Staff Director; Mr. Bill Wilkins, Minority Counsel;
20 Ms. Anne Moran, Tax Counsel; Mr. John Colvin, Chief Counsel;
21 Mr. David Brockway, Chief of Staff, Joint Committee on
22 Taxation; and Mr. Bruce Kayle, Legislation Attorney, Joint
23 Committee on Taxation.

24 (The press release announcing the hearing follows:)

25

1 The Chairman. The Committee will come to order.
2 Senator Long has called in and he has a bad cold today, but
3 according to my expected attendance, everyone, save one, is
4 due at the committee. I wonder if we might act on the
5 nomination of Robert Kimmet to be General Counsel of the
6 Treasury. He had his hearing yesterday and came through his
7 investigation with flying colors, and I think he is a very,
8 very qualified person. And I would like to move to report
9 him out subject to a quorum arriving.

10 Senator Chafee. I second it.

11 The Chairman. Any objection?

12 (No response)

13 The Chairman. Without objection. Let's move on to the
14 imputed interest bill. I wonder, John, if I might call on
15 you and Mr. Brockway at least to give us a rough idea of
16 what the House did. Is the House bill revenue neutral?

17 Mr. Colvin. Yes, Mr. Chairman.

18 Senator Chafee. Mr. Chairman, what does that mean --
19 revenue neutral in this instance?

20 Mr. Colvin. It contains provisions that lose revenue,
21 which are offset by provisions which gain revenue, and over
22 a five-year basis, it is revenue neutral.

23 The Chairman. What they did is they liberalized the
24 rules a bit from what we had previously passed, and to pick
25 up the cost, they raised the length of depreciation on real

1 estate from 18 to 19 years, and that picks up the money that
2 they needed to make the bill revenue neutral.

3 Senator Chafee. The only trouble with that, Mr.
4 Chairman, is that if that is considered revenue neutral,
5 we are letting them into the area of the whole tax reform
6 program where they are eating away at some of the revenue
7 that is going to be needed in the tax reform program to make
8 it revenue neutral, I think.

9 The Chairman. That is indeed true. Assuming in the
10 tax bill we needed to pick up \$2 or \$3 million and we had
11 to go from 18 to 21 percent on depreciation of real estate,
12 we have already gone one year in the House bill on this.
13 So, you would not have that revenue in the tax reform bill.
14 To that extent, you are correct.

15 Senator Heinz. On that point, Mr. Chairman, depending
16 on what we did on tax reform, we might pick up the revenue
17 that we lose.

18 The Chairman. I am not sure that I would want to start
19 down that road in this committee on all the bills we are
20 going to have before the tax bill and say, well, don't worry
21 about revenue neutrality in this one, we will pick it up in
22 the tax reform bill.

23 Senator Heinz. But I think John Chafee asked a good
24 question.

25 Senator Chafee. Thank you.

1 (Laughter)

2 Senator Heinz. And it is an unusual event on a first
3 attempt.

4 (Laughter)

5 Senator Heinz. Because you are always questioning my
6 amendments, but if going from 18 to 19 years undercuts any
7 revenue that we might pick up for tax reform, I suspect that
8 we will pick up revenue involving the liberalization on
9 imputed interest that is involved here.

10 The Chairman. Pick up revenue?

11 Senator Heinz. Yes. If in fact we eliminate interest
12 deductions for everything as proposed by the President except
13 for the mortgage on a principal residence, then we will pick
14 up virtually all of the supposed revenue loss involved in
15 these imputed interest decisions.

16 The Chairman. Oh, I see. Yes, you will but the
17 President is already counting that pickup of revenue in the
18 tax reform bill. I mean, you can't pick it up twice.

19 Senator Heinz. But if we change the law, we will pick
20 it up a second time because this is not the law yet.

21 The Chairman. What you are saying is if you limit the
22 interest deductions, whatever we do with this bill is clearly
23 going to limit real estate transactions. So, it is going to
24 limit the loss.

25 Senator Heinz. Yes.

1 The Chairman. And it will have that effect whether or
2 not we pass this bill.

3 Senator Heinz. That is right.

4 Senator Symms. Mr. Chairman, I might just say that we
5 are going to have a bigger revenue loss if we don't correct
6 the situation that exists as a result of passing the 1984
7 bill than if we do because a big percentage of real estate
8 transactions are partially seller financed today and they
9 would just stop being done.

10 Senator Chafee. Now, wait a minute. That is what the
11 purpose of the hearing is. I am not sure that I would agree
12 with that conclusion -- that the real estate transactions
13 are going to grind to a halt if we don't give real estate
14 operators a great big break, just to set the tone of the
15 hearing.

16 (Laughter)

17 The Chairman. We have given a fair break with that
18 \$2 million exemption which is going to take care of a great
19 many seller financed, fair-sized real property transactions.

20 Senator Symms. Mr. Chairman, if I could make just one
21 suggestion to you, what I would like to see the committee do
22 is just pass a simple, clean repeal of the portion of the
23 bill that affected imputed interest in 1984, which would put
24 us back to the 1964 law and allow the chairman and his
25 conferees to go to conference with the House and just work

1 out somewhere between a clean repeal and what the House did.
2 And we are going to address this whole thing, I assume, in
3 the tax reform anyway, and you would have it. We could do
4 it simply that way. You know, otherwise, I know Senator
5 Durenberger has amendments. I have amendments that I know
6 have a lot of support on this committee. So, what do you
7 think would be a simpler way to do this? Just to repeal
8 what you have done in 1984 and then let you go to conference
9 with the House.

10 The Chairman. And work out wherever we want to come out
11 with with the House. As the chairman, I am not adverse to
12 that suggestion.

13 Senator Symms. I hope that it would be somewhere between
14 outright repeal and what the House did, but it seems to me
15 like that would be an easier way to do this.

16 Senator Chafee. Mr. Chairman, that may be an extremely
17 way to it, but --

18 Senator Symms. I would be happy just to repeal it, as
19 the chairman knows, and we will wait until after tax reform
20 is complete and see where we are, and get rid of all the
21 confusion out there.

22 The Chairman. What would be the revenue loss, Mr.
23 Brockway, if we just go back to the 1964 rules?

24 Mr. Brockway. That was estimated at about \$2 million
25 over a three-year period and it grows over the years. So,

1 you are talking somewhere in the neighborhood of \$7 to \$8
2 billion over the six-year period you are talking about.

3 The Chairman. But as I understand what Steve is saying,
4 he is talking about just basically a stop-gap measure. We
5 have to do something by the 1st of July.

6 Senator Symms. That is correct.

7 The Chairman. But you are saying basically pass a
8 placebo here. Just say repeal everything and go back to
9 1964 and go to the House, knowing full well we are going to
10 negotiate something that is close to revenue neutral
11 hopefully, based upon the House's bill and our total repeal.

12 Senator Symms. Correct.

13 Senator Chafee. I have an alternative suggestion. Why
14 don't we just extend the measure that we are operating under
15 for another six months?

16 The Chairman. I think in fairness to those who would
17 like some certainty, that going along extending for six
18 months and extending for six months and extending for six
19 months isn't fair to them.

20 Senator Chafee. I am not wild about Senator Symms'
21 suggestion because when you then go to conference, you are
22 operating between zero and what the House has done, which is
23 under the limitations you operate under, and then you come
24 down somewhere lower than the House. And I am not for that,
25 as one member.

1 The Chairman. If we do that, John, we have a \$2 billion
2 revenue loss coming out of committee.

3 Senator Chafee. Yes, I know.

4 The Chairman. And I would like this committee to at
5 least have the appearance of responsibility --

6 (Laughter)

7 Senator Chafee. I am not the one proposing it.

8 The Chairman. You are just saying it is between that
9 and Steve's suggestion. You would rather just extend what
10 we have had in this committee for six months and go to
11 conference with that, rather than passing what Steve is
12 suggesting and go to conference.

13 Senator Chafee. Sure. Sure. Or let's go forward with
14 the hearing. We are all gathered here, and let's see where
15 we come out in the Senate, what we come up with.

16 The Chairman. I would like to start out by finding out,
17 because I sense a difference of opinion, as to whether or
18 not we would like to aim toward revenue neutrality, not come
19 out with a bill that loses money as we reported out of the
20 committee.

21 Senator Chafee. The trouble, Mr. Chairman, is that --
22 let's say we decide to be revenue neutral, and Senator Symms
23 and others who believe as he does, advance a proposal that
24 loses a lot of revenue. So, we make that up by extending
25 the depreciation period, for example, to 20 years.

1 But that eats away at the revenue that, it seems to me,
2 we have got to obtain in the tax reform program which involves
3 issues far beyond this.

4 In other words, we are whittling away at available
5 revenue that is needed to make the tax reform program
6 revenue neutral.

7 Senator Heinz. I understand what John is saying, but I
8 am not really quite sure it works out that way, if the tax
9 reform bill in fact applies to both the transactions where
10 there are tax breaks and the transactions where there are
11 revenue gains.

12 As I understand it, the chances are that it is supposed
13 to apply to both sides.

14 The Chairman. Mr. Brockway?

15 Mr. Brockway. I think that the proposal Senator Chafee
16 is talking about would have a relatively small revenue loss,
17 if you extended that stop-gap of existing law on a permanent
18 basis. That would be about \$600 million over the five-year
19 period, if it were done on a permanent basis.

20 If it were done on a permanent basis, it would have a
21 much smaller revenue loss.

22 The proposal that Senator Symms was talking about would
23 have a fairly significant revenue loss, compared to the
24 House bill. As I said earlier, it would be about \$2 billion
25 over the three-year period.

1 So, over the longer period, it would be somewhere in
2 the \$7 to \$8 billion range, and if you decide to make that
3 revenue neutral, we don't have the numbers at the moment on
4 what you would do--how long you would have to extend the
5 appreciation life if you decided to do it that way, but it
6 would be significantly more than the 19 years in the House
7 bill.

8 The Chairman. If we adopted Senator Chafee's proposal,
9 it wouldn't take much of an increase at all to make it
10 revenue neutral.

11 Mr. Brockway. No, it would not. You could do that with
12 a--and you might not have to change the legislation. You
13 might be able to do something else if the revenue involved
14 would be small enough.

15 The Chairman. I am not adverse to what Senator Chafee
16 is suggesting, so long as the committee understands that it
17 would be my full intention to go to conference and come out
18 with a revenue neutral permanent solution by the 1st of July.
19 Basically, what the committee is saying let's delegate this
20 to the conferees, how this will come out and take two or
21 three on the Republican side and two or three on the
22 Democratic side and off we go to conference.

23 Senator Heinz. Mr. Chairman, I think what we are really
24 arguing about is: Are we going to start marking up the House
25 bill, or are we just going to substitute what we did six or

1 eight months ago? I think we ought to mark up the House bill
2 and go from there.

3 I don't think -- as I sense the interest of the members,
4 and maybe I am wrong -- but people do want to simply bank on
5 a tactical move that would allow the conferees, who may do
6 a very good job, but I myself would be reluctant to simply
7 extend what we did several months ago.

8 Senator Symms. Mr. Chairman, I would rather have the
9 House bill than what we did.

10 The Chairman. You would rather have the House bill than
11 the stop-gap?

12 Senator Symms. Correct. And I would like to amend the
13 House bill. If we are going to go ahead with it, I have an
14 amendment which would I think take care of the problems that
15 Senator Chafee has, and that is about some of the abuses that
16 have taken place.

17 The Chairman. I want to find out first if the committee
18 wants to go forth with something here or just pass a placebo.
19 And if they want to go forth with something, do they want to
20 make an attempt at it to be revenue neutral, whether it is
21 like the House bill or totally different from the House bill.

22 Let me put the first question. Do we want to just pass
23 a placebo out of here, and we will go to conference and see
24 what we can work out?

25 Senator Symms. What would be the placebo? Do you mean

1 just to repeal the 1984 Act?

2 The Chairman. You could repeal it. You could do what
3 Senator Chafee says. I mean, there is a number of things
4 you could do because we would all understand that what we
5 are doing is irrelevant.

6 (Laughter)

7 The Chairman. And what the conference is going to do is
8 going to be what is relevant. We will just whisk it through
9 the Senate, and we will all agree to no amendments, and we
10 will go to conference and we will come out with something.

11 There is ample room between either the present law or
12 the temporary extension or a total repeal to negotiate with
13 the House and come out with something.

14 Senator Symms. Mr. Chairman, the suggestion I made, I
15 didn't mean for it to be irrelevant. I want to make it
16 very clear that what I am talking about is: I believe that
17 we are having a significant loss in GNP and a job loss and
18 a loss in Federal revenues by what was done in 1984 because
19 it has been an impediment to real estate transactions.

20 The static numbers that the Treasury and the Joint Tax
21 Committee have to use, by the nature of the way we do things
22 here, I am not being critical of them, but the system doesn't
23 really reflect what happens in the market as far as the number
24 counting is concerned.

25 So, you know, if we did this, what I would be saying is

1 if we pass a repealer of this 1984 Act, and the chairman goes
2 to conference, I would hope that you would come back with
3 something that would be between what the House did and an
4 outright repeal.

5 So, you could take my abusive amendment that I have here
6 and try it on the House. I think they would probably agree
7 with this. What it basically does is set the interest rate
8 at 12 percent, and that is the maximum interest rate that
9 you can impose in seller financing, and that one-third of
10 the excess, if any over 12 percent of the Federal rate,
11 otherwise applicable to such transactions, would be so there
12 would be a governor on how fast this thing would have to go
13 up.

14 Now, all of the projections, whether they are correct or
15 not -- that is anybody's opinion, I suppose -- are that
16 interest rates are going down and not up.

17 So, this would be a way to stop the abusive practices
18 that some senators are concerned about.

19 The Chairman. I want to go back to this question now.
20 I want to know if we want to send out -- assuming we are not
21 just going to send out something that is irrelevant because
22 we know we are going to negotiate -- whether we want to send
23 out a revenue neutral bill or whether we want to accept the
24 fact that we will send out one that loses revenue based upon
25 projections that some people may or may not regard as valid.

1 They are the only projections we have. I know what you
2 mean, and I know what you mean by static projections and how
3 are people going to react or not react, depending upon the
4 law, but we have got to go on some projections.

5 Senator Symms. What I am saying is I don't want you to
6 go over there and raise the depreciation schedule to 25 years
7 to pay for something that is not going to actually happen.
8 That would be a loss to --

9 The Chairman. We clearly couldn't do that because we
10 have got an 18-year now and the House went to 19 years on
11 their bill, and then there are rules of conference. We
12 couldn't go beyond that.

13 Senator Symms. All right.

14 Senator Chafee. I missed that, Mr. Chairman. We could
15 go to conference and whatever we set the depreciation
16 schedule, that is what the House has. I mean if we should --

17 The Chairman. If we did nothing --

18 Senator Chafee. No, no. I appreciate it if we did
19 nothing, but if we did something and it ended up with us
20 with a 25-year depreciation, just to take a figure, that
21 is perfectly --

22 The Chairman. That is perfectly what?

23 Senator Chafee. Suitable for conference.

24 The Chairman. Oh, yes. They have got 19 years, and we
25 have 25 years. That is correct.

1 Senator Symms. Mr. Chairman, the amendment I am going
2 to offer if you don't pass this placebo out is revenue
3 neutral anyway, according to the projected figures, because
4 everybody is projecting that interest rates are not going to
5 be above 12 percent.

6 So, on their static projections, this amendment I have
7 is actually revenue neutral for the next five years, but it
8 does put a governor on how high interest rates could go.

9 Now, if interest rates went to 25 percent, I suppose we
10 would have to come back and take another look at it.

11 The Chairman. Is this, Steve, the antiabuse amendment?

12 Senator Symms. The antiabuse amendment.

13 The Chairman. Mr. Brockway, how does that come out
14 revenue neutral?

15 Mr. Brockway. If I understand what this amendment is --
16 there have been two antiabuse amendments. One, an earlier
17 version, said that if you have met certain tests, you would
18 not be subject to the 100 percent of the Federal rate at all.

19 What this amendment says, as I understand it, is that
20 as long as the term of the note is short enough or certain
21 other criteria are met, that when interest rates go above 12
22 percent, you don't impute at a full 12 percent. When the
23 Federal rate goes above 12 percent, you don't impute at that.
24 It only goes above partially.

25 It would be one-third of the excess. So, if you went to

1 15 percent, then the Federal rate --

2 The Chairman. If the Federal rate went to 15 percent?

3 Mr. Brockway. Then they would only have to impute if
4 you passed these criteria at 13 percent, rather than 15
5 percent.

6 The Chairman. One percent of the difference, you mean?

7 Mr. Brockway. One-third of the difference. If it went
8 to 18 percent, then it would be 14. The reason why we don't
9 attribute any estimate to it is that, as Senator Symms has
10 said, we are estimating on the basis of what the OMB and CBO
11 projections of interest rates are, and we see those falling
12 in the out years in our models.

13 So, this amendment would never have an effect.

14 Obviously, if the interest rates did go up so that the
15 amendment did have an actual impact, then it would lose
16 revenue under those circumstances, but assumptions are that
17 in the next five years interest rates will go down, and so
18 this would not have an impact.

19 Senator Symms. But there is one other thing. On the
20 minimization of the loss, though, John, the total amount of
21 seller financing does not exceed 50 percent of the total
22 purchase price, and in the case of any depreciable property,
23 no seller financing is for a term longer than two-thirds of
24 the recovery period.

25 So, I mean, according to the terms of the financing, at

1 least 80 percent of the total stated and unstated interest
2 under this section attributable to seller financing must be
3 paid.

4 Mr. Brockway. That is correct. Not all transactions
5 would qualify for this special governor if the interest rates
6 went above, but assuming the interest rates did go above, I
7 guess, in our view those restrictions would not operate to
8 cut out a large number of transactions.

9 Most transactions would qualify for the lower rate if
10 interest rates do go above 12 percent. It is just that we
11 don't project them to go above 12 percent.

12 The Chairman. Then you would have a revenue loss.

13 Mr. Brockway. You would. Very definitely.

14 The Chairman. But you project they are not, for the
15 foreseeable future, going to go above 12 percent. Then it
16 is revenue neutral. I mean, if it never comes into effect,
17 it is revenue neutral.

18 Mr. Brockway. That is correct.

19 Senator Symms. All I am trying to get at, Mr. Chairman,
20 is what are legitimate economic nontax-motivated, seller
21 financed transactions -- which are what? -- 99 percent of
22 them are.

23 They are just people who want to legitimately sell their
24 property. The right kind of private financing is not
25 available. Most of them aren't financing the entire portion

1 of it. They are financing a part of the deal, and other
2 financing methods are involved.

3 And it would just provide a safety valve for them.

4 The Chairman. I would be willing to accept that. I
5 know what your antiabuse amendment is. I would be willing to
6 accept it because I think it, by any fair stretch, is revenue
7 neutral, assuming we stay below 12 percent.

8 And I am not going to try to second guess OMB and CBO
9 and the others who are projecting. They may be wrong, but
10 I have no basis to assume they are wrong.

11 Senator Symms. Then, I would suggest that I offer the
12 amendment, the committee dispose of it, and send you to
13 conference.

14 The Chairman. There may be other amendments. I am
15 willing to accept yours because it is revenue neutral, as
16 long as the committee is willing to accept revenue neutrality.

17 Senator Symms. I move the amendment.

18 The Chairman. Discussion?

19 Senator Chafee. Wait a minute.

20 (Laughter)

21 Senator Chafee. He moved what amendment?

22 The Chairman. The antiabuse amendment.

23 Senator Symms. The antiabuse amendment.

24 Senator Chafee. Then, that takes care of the session
25 today?

1 The Chairman. No, no.

2 Senator Symms. It takes care of part of it.

3 Senator Chafee. The Symms amendment is just protection
4 on the up side, is that it? The 12 percent?

5 Senator Symms. What it does, in a nutshell, is that it
6 puts it at 12 percent, and if interest rates go above 12
7 percent, one-third of the excess, if any, over 12 percent of
8 the Federal rate otherwise applicable to such transactions.

9 So, if interest rates went to 15 percent, then it would
10 have a governor at 13 percent. And then, there are some
11 other requirements that you have to meet so that it can
12 demonstrate that it is not-- And the other requirements are
13 that the property is not depreciable by the purchaser.

14 The total amount of seller financing does not exceed
15 50 percent of the total purchase price. In the case of
16 depreciable property, no seller financing is for a term
17 longer than two-thirds of the recovery period.

18 And according to the terms of such financing, at least
19 80 percent of the total stated and unstated interest as
20 determined under this section to be attributable to seller
21 financing must be paid.

22 So, there is a built-in-- What this would do is allow
23 for legitimate, nontax-motivated seller financed transactions
24 to take place, but it would provide a safety valve in times
25 of high interest to prevent the real estate and construction

1 industries from paralysis.

2 I mean, that is really what it basically would do.

3 Senator Chafee. It seems to me, Mr. Chairman, that
4 if I understand the Symms amendment correctly, you are
5 protecting people on the up side from the imputed interest.
6 And there is an assumption there that these are innocents
7 that have been caught up in these \$4 million deals without
8 fully understanding that it is an arrangement that gives
9 them great benefits.

10 And thus, we are going to keep the Federal Government
11 from imputing an interest at what the interest actually is.

12 And we have seen interest rates at 21 percent in this
13 country, and I hope they don't come back, but certainly in
14 1977, no one dreamed that we were ever going to hit 21
15 percent by 1980.

16 So, I don't see the purpose of the amendment. Again,
17 as I say, it is based on the assumption that these people
18 don't know what they are doing.

19 And people don't wander into transactions of these sizes
20 in which they know the Tax Code thoroughly, which gives them
21 tremendous advantages in the capital gains in receiving a
22 so-called lower interest.

23 The reason we have these statutes is to impute the
24 interest that actually should be there. And to limit it
25 because it gets high, it seems to me is not fair to the

1 taxpayers of the nation who are going to have to make this
2 up in another way.

3 The Chairman. John, all I am saying that is for the
4 next five years, the projections we have on interest rates
5 are down.

6 They can be as wrong as any of us, but when we do our
7 projections in this committee and our revenue estimates in
8 this committee, we operate on certain assumptions as to the
9 cost of Treasury money and everything else.

10 If the projections are correct, then his amendment is
11 revenue neutral.

12 Senator Chafee. But why protect these people on the
13 up side? I don't get it.

14 Senator Symms. The reason you protect them is so that
15 you don't have a GNP loss in stopping of legitimate nontax
16 motivated transactions.

17 Somebody wants to sell their farm in Twin Falls, Idaho,
18 and I was just in Twin Falls last week and visited one of
19 the large real estate companies that handles a lot of farm
20 and commercial properties.

21 They say that 75 percent of the transactions that they
22 have been doing in the last two- or three-year period involved
23 some portion of the deal to be seller financed.

24 Senator Chafee. Oh, yes. There are plenty of
25 transactions that are seller financed.

1 Senator Symms. And it is not 100 percent seller
2 financed. In most cases, it is a small portion -- a third,
3 one-half, part of a total deal. They get some financing
4 from a commercial bank and some from some insurance company
5 or something, and then the seller provides some of the other
6 financing.

7 And all this does is provide a governor on how high up
8 those rates would go and limits-- And it pays attention to
9 what the applicable Federal rate is, but it would give some
10 protection about forcing them to make these transactions at
11 an excessively high interest rate that won't bring about a
12 transaction.

13 The Chairman. Senator Heinz?

14 Senator Heinz. Mr. Chairman, I came in here kind of
15 wondering how we were going to deal with all these issues.
16 Dave Durenberger has a couple of amendments. Steve has an
17 amendment.

18 I started out on the imputed interest problem, saying to
19 myself, the best solution is really the very first one that
20 Steve Symms enunciated, which is it has worked out all right,
21 so let's leave it alone, let's not get the Government with
22 its hands in all these transactions.

23 That point of view clearly isn't going to prevail, and
24 so living, as we often do, in a second-best world, since we
25 are not going to do that, what has the House sent us?

1 What the House has sent us is a proposal that basically
2 says where small transactions, i.e., under \$2 million, are
3 involved, which certainly covers every transaction involving
4 the sale of 99.5 percent of all residential real estate, and
5 I suspect a good deal of the valuation involved in selling
6 any small business property.

7 What we have said is we are going to have a pretty
8 darned decent rule, that is to say, 9 percent or 100 percent
9 of the applicable Federal rate, as defined, whichever is
10 lesser -- whichever is lesser for those transactions under
11 \$2 million.

12 What Steve is really saying here, I guess, is that that
13 is all right certainly for the \$2 million people, even though
14 he and I start out saying we don't want to get into it in
15 the first place, but on the big transactions, there ought
16 to be another rule that safeguards the real estate industry.

17 I have, after listening to all of this, concluded that
18 probably the best thing we can do -- if we get into another
19 high interest rate boat -- is keep everybody in the boat.

20 I am more worried as I listen to the possibility of
21 interest rates going up and I recollect the 21 percent
22 interest rates -- when by the way there were a lot of real
23 estate fortunes being made -- I get really worried about
24 letting people out of the boat who might help us solve the
25 problem of bailing the water out of the boat, which we would

1 all be pretty close to the gunnels if we got up around 15 or
2 20 percent interest rates.

3 So, my instinct, and what I think I am going to do is I
4 am going to oppose Steve's amendment, and I am probably going
5 to oppose any other amendments that liberalize things above
6 \$2 million.

7 Not that that is philosophically consistent, but as I
8 think of the solutions to the real problem that we might get
9 into down the road, which is, let's face it, a large Federal
10 deficit driving high interest rates, frankly I want everybody
11 -- everybody we can find, and particularly the people who I
12 guess would like some special protection -- to help us deal
13 with that because it is going to take some more tough
14 decisions.

15 As tough as the budget was, it doesn't solve that
16 problem. And certainly tax reform, given its revenue
17 neutrality, isn't going to help solve that problem.

18 So, I am with some reluctance going to oppose my friend's
19 proposition, unless I learn something new.

20 Senator Symms. Before you make your mind up on that,
21 let me just point out that when the Abdnor-Dole amendment
22 passed the Senate last year, it was much more liberal on this
23 question than my amendment is.

24 It was a less stringent antiabuse amendment, in the
25 Abdnor-Dole amendment, that the Senate passed.

1 This amendment, if my information is correct, says that
2 there is going to be no -- and I have asked John to verify
3 this -- but there will be no tax benefits for either the
4 buyer or the seller.

5 This is an antiabuse amendment, but it does allow for
6 the governor to be in there so that we just don't get real
7 estate and these kinds of transactions ground to a halt again,
8 like what happened in those excessively high interest rate
9 years.

10 The Chairman. You are also saying, Steve, that to the
11 extent the interest rate is under 12 percent, these large
12 transactions will be governed by the provisions of the \$2
13 million and \$2 to \$4 million and above \$4 million in the
14 House bill.

15 Senator Symms. I am not sure I can answer that
16 correctly.

17 The Chairman. That is as I understand it.

18 Mr. Brockway. That is my understanding of the amendment.

19 The Chairman. Yes.

20 Senator Symms. Is that correct, John?

21 Mr. Brockway. That is correct.

22 Senator Symms. All right.

23 Senator Mitchell. Mr. Chairman, may I ask a couple of
24 questions?

25 The Chairman. Sure. Excuse me, George. While we have

1 a quorum here, I would like to report out Mr. Kimmitt, and I
2 need a quorum, but go ahead until he comes back in.

3 Senator Mitchell. I would just like to ask a question.
4 Steve, where does the 12 percent -- what is the basis of the
5 selection of that rate?

6 Senator Symms. I think that the basis of the selection
7 is that it is viewed as a starting point. Where are we right
8 now, John? Aren't we at 12 percent? What is the applicable
9 Federal rate?

10 Mr. Brockway. Just under that. Right now, 100 percent
11 of the AFR range is at 10.36 and 12.21.

12 Senator Symms. I think 12 percent because it has only
13 been above that two or three times in the last 20-year period
14 and that that is a protection point.

15 If interest rates went up six percentage points from 12,
16 so you had 18 percent rates on the AFR rates, then you could
17 have seller financed transactions at 14 percent.

18 Senator Mitchell. According to this chart that I have
19 before me, it has gone over 12 percent for a substantial
20 period in just the past five years.

21 Senator Symms. That is correct.

22 Senator Mitchell. Then, let me ask another question.
23 I understand your argument about revenue neutrality based on
24 the expectation that interest rates will not rise above that
25 level and therefore this provision will never be in effect.

1 Obviously, if that is true, then this is unnecessary.
2 Could I ask whether there is any way of estimating what the
3 revenue loss would be in the event interest rates did rise
4 above it? Is that because we don't know what the rates will
5 be and for what period of time?

6 The Chairman. Mr. Brockway?

7 Mr. Brockway. You would have to assume an interest rate
8 level -- where they are going to go -- and then we could run
9 the model, assuming let's say 15 percent interest or
10 something, but that would take some time.

11 Senator Mitchell. It would require initially a specific
12 assumption of what a rate would be over some fixed period
13 of time, would it not?

14 Mr. Brockway. That is correct. In fact, that is the
15 way we have done these estimates, but we have just assumed
16 for revenue estimating purposes and we followed CBO's
17 projections of where interest rates are going to go, and they
18 are going to decline over time according to their projections.

19 Senator Mitchell. Yes.

20 Mr. Brockway. So, these estimates that we have made
21 already are based on the assumption of interest rates, and
22 we just come up with another assumption of where they are
23 going to be and get a revenue effect.

24 The Chairman. Let me just interrupt while we have a
25 quorum. This is to report out Bob Kimmitt, and there was no

1 objection to him. He made a very good impression yesterday.

2 Is there any objection to reporting out Mr. Kimmitt to
3 be General Counsel of the Treasury?

4 (No response)

5 The Chairman. Without objection.

6 Senator Mitchell. If I could merely ask another question
7 but go ahead, Steve.

8 Senator Symms. If interest rates to their historic
9 highs with the AFR reaching 16 percent in 1988 and remaining
10 at that level through 1990, according to my figures, the
11 revenue loss would be \$39 million over 1986 to 1990 period,
12 and that is based on a study by the Deseveer Data Company.

13 Senator Mitchell. Mr. Brockway, are you able to comment
14 on that?

15 Senator Symms. Could you affirm that?

16 Mr. Brockway. It would take some time to do it. My
17 hunch is that we would come in with a significantly higher
18 number than Deseveer has come up with on that assumption, but
19 I really don't know.

20 We would have to run it through our model under a given
21 interest rate assumption.

22 Senator Symms. What I am really saying is that this may
23 become a moot question in another year if, in fact, there is
24 tax reform that may address this, but it would seem to me
25 that it would be very prudent to pass this minimum governor

1 on how high these rates go, just as a confidence builder, you
2 might say, for what might happen in the future.

3 And I don't think it is going to be a revenue loss, and
4 it seems like it would be a prudent thing for the committee
5 to do.

6 Senator Mitchell. But you see, I thought you made a
7 pretty reasonable argument, but you have made an argument
8 that really cuts both ways.

9 You have stated repeatedly that there will be no revenue
10 loss as a reason to vote for this, but of course, that is
11 based on the expectation that the provision will never go
12 into effect.

13 Senator Symms. No.

14 Senator Mitchell. And if you are confident enough that
15 interest rates won't reach that level, then we don't need it.

16 Senator Symms. George, you see, I am forced to play by
17 the rules we use here. I said this earlier before you got
18 here. I am more concerned about the revenue loss that we
19 will have if we don't have this in the law than the revenue
20 loss because of the grinding to a halt of transactions
21 and the slowdown of the GNP and the job loss and all the
22 things that go with it if we have any interferences to
23 seller financing -- any more interferences, I should say to
24 seller financed transactions.

25 But the way that they do the numbers here, because of the

1 static computation of the numbers that Treasury does and the
2 Joint Tax Committee does, I have to point that out. The same
3 people are all projecting lower interest rates.

4 Whether we agree with that, that is another matter.

5 The Chairman. I wonder if I might suggest this, Steve,
6 as a compromise. What about putting a three-year sunset on
7 your antiabuse provision, and if by chance the interest rates
8 go above 12 percent in the next three years -- none of us
9 expect it, but if they did -- that is a fairly significant
10 increase quickly, and they would be taken care of during the
11 three years.

12 If it hasn't happened during the three years, then we
13 have got a sunset and we can come back and revisit it.

14 Senator Symms. All right.

15 The Chairman. I am reluctant to predict beyond three
16 years what may happen. I don't know.

17 Senator Symms. I accept that.

18 Senator Armstrong. We had 9 percent in the law for a
19 long time, and without anybody really knowing what was
20 happening, or without at least any knowledge on the part of
21 a lot of the members, it suddenly got taken out of the law.
22 It was in the middle of an item in one of those committee
23 bills, and it doesn't seem to me, Steve, that taking the
24 three-year sunset would be hard to accept.

25 It certainly doesn't seem unreasonable to me.

1 The Chairman. I think we could set it at 12 percent and
2 take three years, and I think that is a fair compromise, Bill.

3 Senator Armstrong. Except that if interest rates are
4 20 percent at that time, you would just set the stage for
5 a confrontation, which is what we really ought to avoid.

6 Mr. Chairman, let me also make a point that the kind of
7 transactions we are talking about are not people who are
8 looking for ways to evade paying taxes, so much as it is
9 people who are being trapped into being forced to make
10 certain types of transactions -- people who are moved across
11 the country and have to sell their homes on some basis or
12 another, or somebody who has got a farm for sale and that
13 type of thing.

14 Even if interest rates exceed 12 percent, even if they
15 go to 20 percent, it seems to me 12 percent is the reasonable
16 place to put the imputed figure.

17 The Chairman. But we have reasonably taken care of
18 those people with the \$2 million and the \$2 million and \$4
19 million exemption.

20 You have got to have a pretty good home or a pretty good
21 farm not to fit within those two categories.

22 Senator Armstrong. That, of course, is correct, and it
23 really applies more to a small business situation and estate
24 situations.

25 If I could just ask one question. In the case where

1 interest rates go to 20 percent, and you have an imputed
2 interest rate provision, do we really have a revenue effect
3 anyway, or isn't the effect simply to shut down the market?

4 In other words, you are not really going to get any
5 taxes paid on things such as this, are you?

6 The Chairman. You mean, people are not going to make
7 any deals if the real interest rate is 20 percent and they
8 are stuck with a 12 percent?

9 Senator Armstrong. Isn't it possible that the real
10 revenue effect is that you get some revenue if, in effect,
11 they had a safe harbor at 12 percent and you would get none
12 if it goes up to 20 percent?

13 The Chairman. I am not sure.

14 Senator Symms. See, if it went to 20, the safe harbor
15 would be 14.5 or 14 and two-thirds or something.

16 Mr. Chairman, just as a compromise with your suggestion,
17 which if it is the wish of the committee I would accept your
18 suggestion, although I tend to agree with what Senator
19 Armstrong said, probably what we ought to say is that at the
20 end of three years, we will relook at the 12 percent.

21 It may be that, if all the projections are correct, that
22 to make it correct, we ought to lower it.

23 The Chairman. That is clearly what we would do at that
24 time.

25 Senator Symms. Or the other way. In this committee, we

1 would all like to think that interest rates will be at 8
2 percent three years from now and not 16, but we don't know.

3 The Chairman. Is there objection to adopting the sunset?

4 Senator Chafee. Yes, there is, Mr. Chairman. I think
5 we have to realize what we are doing here. As Senator
6 Armstrong got into the home or the farm, this is not a \$2
7 million transaction. It is \$2 million of debt. You could
8 have a \$5 million transaction, and it is the \$2 million of
9 debt that is involved.

10 The Chairman. Senator Chafee is correct. It is the
11 seller financing that is the key, not the amount of the
12 transaction.

13 Senator Chafee. Yes, and indeed there could be other
14 debt. It is just the seller financing that is involved.
15 That is the first part.

16 So, these are not just some stricken persons who are
17 having to give up their homestead to be transferred to New
18 York.

19 Senator Armstrong. You are right.

20 Senator Chafee. And then, furthermore, in the House
21 bill, Section 8, there is a provision. The Treasury
22 Department is authorized to issue regulations under which
23 taxpayers may show that in appropriate circumstances an
24 interest rate less than 100 percent of the AFR may be used.

25 So, that is in there, but I think we have got to realize,

1 Mr. Chairman, that what we are dealing with here is the
2 Government is imputing interest to transactions where the
3 belief is that the seller and buyer went into a deal without
4 setting the proper interest rate.

5 And there are all kinds of tax benefits that encourage
6 them to do this. It isn't just that the Federal Government
7 is getting into an area where they shouldn't poke their nose
8 at all. They are in it deeply because of the tax
9 consequences.

10 And the tax consequences are that the seller raises the
11 price which gives him a larger capital gain. He takes a
12 lower rate of interest and it gives the buyer a greater
13 depreciation.

14 These aren't innocents who are not knowing what they
15 are doing. There are not many \$4 or \$5 or \$6 million
16 transactions that don't have a lawyer and an accountant --

17 Senator Symms. But my amendment says that the property
18 is nondepreciable by the purchaser.

19 Senator Chafee. And why there should be a cap on this
20 interest to protect these people is beyond me. They ought
21 to do it right from the beginning and if they don't, then
22 they are going to suffer the consequences of the imputed
23 interest.

24 Now, if you don't believe that, then let's throw out the
25 whole imputed interest theory and people could make any deal

1 they want.

2 Senator Symms. Senator, let me comment on that point.
3 Let me just go through the criteria before you can get in
4 on my nonabuse amendment.

5 The transaction is either the total amount of seller
6 financing--does not exceed 50 percent of the purchase price.
7 That is the first point.

8 The second point is the case of the depreciable property.
9 No seller financing is for a term longer than two-thirds of
10 the recovery period determined under Section 168, and
11 according to the terms of such financing, at least 80 percent
12 of the total stated and unstated interest as determined under
13 this section is attributable to seller financing must be
14 paid, and the property is not depreciable by the purchaser.

15 So, I think your concerns are met with the criteria test
16 of this amendment. I appreciate your concerns, but it appears
17 to me that--let's say this deal is a \$20 million deal and
18 only \$2 million of it is seller financed. And let's say the
19 interest rates are 18 percent, so it is financed at 14
20 percent, instead of 18 percent.

21 But that little \$2 million in the \$20 million transaction
22 is what made the deal come together, and the transaction
23 takes place, and the Treasury receives a large payment from
24 the seller who received a payment from the purchaser.

25 And so, a transaction did take place. Treasury received

1 some money, and they lost a slight bit of revenue in the 4
2 percent difference interest between 14 and 18 percent that
3 was paid.

4 It just appears to me that if this will help make these
5 transactions take place that the long-range beneficiary of
6 this will be a stronger, more viable economy and more revenue
7 flow to the Treasury.

8 And I think your concerns are simply going to be met by
9 this amendment, and if it helps make some of these
10 transactions, then we are all the beneficiaries of it.

11 The Chairman. Let me take Dave who had his hand up
12 and then Lloyd Bentsen.

13 Mr. Colvin. Mr. Chairman, a point of clarification.
14 Earlier, Senator Symms you said "or not depreciable," and
15 I believe that is how you intend the amendment to work -- not
16 "and not depreciable."

17 Senator Symms. Yes, you are right.

18 Senator Durenberger. All right. I am going to be real
19 brief, and I apologize for being late. I may have a little
20 to say later on a couple of amendments, but if we are going
21 to vote on this 12 percent cap, I don't want anybody to get
22 the notion when Bill Armstrong said he made a mistake that
23 he made a mistake.

24 I mean, we forget as we sit around here in our effort to
25 use Government and some of these characters down here to right

1 all wrongs what is really going on out there in a lot of the
2 very legitimate cases.

3 Those of us who did the tax bill in 1981 remember the
4 debate we had over the intrafamily farm sale -- very
5 legitimate -- trying to keep the family farm in the family.

6 And in an industry in which cash flow is like this, you
7 make arrangements that may look like tax-motivated transfers,
8 but you make an arrangement between a father and a son that
9 will enable the cash flow to finance the passage of the farm
10 from one generation to another.

11 So, I just want to make an argement against John Chafee's
12 view from Rhode Island that these are all tax-motivated
13 transfers. They didn't start out to be tax-motivated
14 transfers.

15 I am sure, as the interest rates in this country went
16 up, a whole lot of folks -- a lot of whom may be sitting in
17 this audience -- got into the business. There is probably
18 no question about it.

19 I don't know who invented the business about the baby
20 and the bathwater, folks, but this has the potential if we
21 let this get out of hand of throwing the baby out with the
22 bathwater.

23 It isn't just the farmers. It is some of these small
24 town newspapers, for example, Mr. Chairman. Their values
25 went up very substantially, and yes, the seller financing is

1 \$2 million, but that is probably the whole worth of the thing.
2 It is the only way you can sell the thing.

3 But it isn't like opening up your checkbook and all of
4 a sudden you have \$2 million in there. That is over 20 years
5 or something like that -- that that \$2 million finally gets
6 in there.

7 A lot of that is just little plain, ordinary folks who,
8 in these high interest markets, have no way to sell it, but
9 I think at best, Steve, if we can't do it here, then I would
10 strongly recommend, Mr. Chairman, that we at least do the
11 12 percent cap.

12 Senator Symms. Mr. Chairman, I would like to vote on
13 this, whenever the committee is ready.

14 The Chairman. Senator Bentsen has his hand up next.

15 Senator Bentsen. I think that in the vast majority of
16 these instances they are what John Chafee says they are,
17 particularly in large deals when you are talking about \$2
18 million being the best part of it.

19 There are certainly some of those that Senator
20 Durenberger is speaking of, but when I listen to these
21 restrictions, the clarification of Mr. Colvin is not quite
22 that restrictive.

23 The restrictions are so stringent that I think you are
24 going to preclude an awful lot of these deals, anyway. And
25 then, you are finally going to get around to the wraparound

1 questions to decide whether you have any realistic way to do
2 that kind of a deal.

3 So, I will go along with Senator Symms, along with the
4 sunset provision because frankly I don't think it is going to
5 apply to a lot of cases.

6 The Chairman. Is there further discussion on the Symms
7 amendment with a three-year sunset?

8 Mr. Carter. Mr. Chairman, could I just make one
9 clarification? On Senator Symms' example, if there is only
10 \$2 million of seller financing, even though the property is
11 worth \$15 million or \$20 million, under the House bill the
12 9 percent rate would apply.

13 So, you wouldn't get into the governor situation. It is
14 only where your seller financing is over \$4 million.

15 And also, I would just like to say that the Treasury
16 has a problem with the governor concept because it does
17 overstate basis in a period of rising interest rates.

18 And just to give you figures: At a 15 percent interest
19 rate, there would be a 20 percent overstatement of basis on
20 a 10-year bullet note.

21 So, you do have this problem, as I think you are well
22 aware, where the interest rates are higher than the amount
23 stated for imputed interest purposes.

24 You are going to get a mismatch in the overstatement of
25 basis, and therefore more investment credit and depreciation

1 that you would expect.

2 The Chairman. Is there further discussion on the Symms'
3 amendment?

4 Senator Chafee. In the Symms amendment, the seller
5 cannot depreciate the property. Isn't that correct?

6 Mr. Brockway. That is not correct.

7 Senator Chafee. I thought that was one of the rules you
8 had in there, Steve. Oh, the buyer can't depreciate it.

9 Mr. Colvin. There are two ways to be eligible for the
10 Symms' amendment. One is if you meet three conditions: if
11 the loan is not more than two-thirds of the recovery period,
12 if 80 percent of the interest is paid currently and, if not,
13 more than 50 percent is seller financed.

14 And there is an alternative way, and that is if the
15 property is not depreciable by the buyer.

16 Senator Bentsen. That is the alternative -- not and.

17 Mr. Colvin. That is correct.

18 Senator Chafee. That makes it even worse.

19 The Chairman. Senator Pryor?

20 Senator Pryor. Mr. Chairman, I am going to support this
21 amendment. I would just like to make a statement. I don't know
22 how this is going to impact on States with usury laws.

23 Our State, for example, has very strict usury laws in
24 the constitution. It might help our situation -- I am not
25 sure -- but I think by the time this bill gets to the floor,

1 that I may have some language that I may want to put in there
2 to look at those States with usury provisions that are very
3 restrictive.

4 And I just wanted to sort of serve notice on my
5 colleagues that I do support Senator Symms, but I think we
6 might have to address this and I might call on these people
7 at the table to help us with this.

8 The Chairman. All those in favor of the Symms' amendment
9 with a three-year sunset will say "aye."

10 (Chorus of ayes)

11 The Chairman. Opposed "no."

12 (Chorus of noes)

13 Senator Chafee. I would like a roll call, Mr. Chairman.

14 The Chairman. The clerk will call the roll.

15 The Clerk. Mr. Dole?

16 Senator Dole. No.

17 The Clerk. Mr. Roth?

18 Senator Roth. Aye.

19 The Clerk. Mr. Danforth?

20 Senator Danforth. (No response)

21 The Clerk. Mr. Chafee?

22 Senator Chafee. No.

23 The Clerk. Mr. Heinz?

24 Senator Heinz. No.

25 The Clerk. Mr. Wallop?

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

1 The Clerk. Mr. Pryor?

2 Senator Pryor. Aye.

3 The Clerk. Mr. Chairman?

4 The Chairman. Aye. And Mr. Danforth aye, by proxy.

5 Mr. Wallop aye by proxy.

6 The Chairman. Let me add very quickly an amendment for
7 Senator Danforth that is a non-revenue losing amendment.

8 Senator Danforth has asked me to present an amendment
9 that delays the effective date changes of rehabilitation tax
10 credit provisions -- one of the conforming amendments in
11 the bill -- from May 9 to May 17.

12 And do I understand, Mr. Brockway, there is no revenue
13 effect?

14 Mr. Brockway. That is correct.

15 The Chairman. I would offer that amendment on behalf
16 of Senator Danforth.

17 Senator Matsunaga. Mr. Chairman?

18 The Chairman. Senator Matsunaga?

19 Senator Matsunaga. I happened to be out of the room
20 when the vote was called. May I be reported as having voted
21 "aye"?

22 The Chairman. Senator Matsunaga is recorded as "aye"
23 on the Symms' amendment.

24 The Danforth amendment is adopted without objection.

25 Senator Heinz?

1 Senator Heinz. Mr. Chairman, I would like to offer what
2 I hope will be a very noncontroversial amendment. We worked
3 very closely with the staff in developing it.

4 It relates to life-care communities. Perhaps some of
5 the members will recall that when we were dealing with this
6 issue last year, we had a colloquy on the floor where our
7 former chairman, the distinguished Majority Leader,
8 acknowledged that the new provision that we had regarding
9 the effect of DEFRA imputed interest would create some
10 problems for existing life-care communities, that that
11 should be taken into consideration by the Treasury Department,
12 that the Treasury should delay the effective date, and at
13 that time, we also agreed that the refundable portion of
14 a residence entrance fee would be the only part subject to
15 taxation and then only for the period they are refundable.

16 What we learned since then is that we really put life-care
17 communities, which aren't nursing homes -- they offer a range
18 of services. The average age of people in life-care
19 facilities is 80 years old.

20 What we have learned is that the deposits people make,
21 which the legislation would protect only up to \$90,000, if
22 they are refundable, what happens is that the Treasury imputes
23 interest and the senior citizen pays income taxes on money
24 that they don't receive.

25 If the deposit is nonrefundable, there is no such

1 problem. There is no interest imputed, and the result is
2 you have a rather interesting Catch 22.

3 If you give the facility \$90,000 and you can't get it
4 back, even though it is technically a deposit -- which I guess
5 you would get back if the facility closed -- I guess you are
6 all right, but if you find after two weeks or a month that
7 the facility isn't living up to its contractual obligations,
8 you are stuck.

9 Your \$90,000 is gone. You never see it again because it
10 is nonrefundable. If you die a month or two months or three
11 months after going in a life-care facility, the \$90,000 or
12 whatever it is is gone. Bad luck to your estate, to your
13 kids.

14 What we have done in this amendment is basically you
15 take the notion that we had in Section 121 where we said
16 \$125,000 in equity in a home is not--will not be taxed and
17 we are really in a sense -- although at a lower level in
18 order to avoid much in the way of a revenue problem, limiting
19 it to the first \$90,000 -- and we are saying, in effect, if
20 you have got \$90,000 which you probably would have gotten by
21 selling your home, and you invest it, if you will, in a
22 life-care community, that first \$90,000 will not be subject
23 to imputed interest even if that deposit is a refundable
24 deposit.

25 We worked very carefully with the staff on this. The

1 Nursing Home Association which, by and large, doesn't
2 represent life-care communities -- it represents nursing
3 homes -- supports this amendment.

4 If we don't pass it, I think we are going to see a real
5 halting of life-care communities -- nonprofit and for profit
6 -- and I would hope that the members would agree that the
7 amendment is meritorious.

8 The Chairman. As I understand it, the amendment is so
9 narrowly drawn that nursing homes would not be able to come
10 within it, the normal way they operate.

11 Senator Heinz. That is correct, and even with that, the
12 American Health Care Association, which represents nursing
13 homes, supports the amendment.

14 The Chairman. Is there discussion on the amendment?

15 Senator Chafee. Mr. Chairman?

16 The Chairman. Senator Chafee, and then, you, Sparky?

17 Senator Chafee. Mr. Chairman, what this does is treats
18 somebody who goes into a deal like this quite differently
19 from the person who doesn't go into it.

20 What it does is: If you put your \$90,000 into a deposit
21 with one of these life-care facilities, as I understand
22 Senator Heinz' amendment, you are entitled to withdraw that.
23 You can withdraw the \$90,000. Is that correct?

24 Senator Heinz. Only if you leave the community.

25 Senator Chafee. That is right. So, you can withdraw

1 that, but while it is there, the income on that \$90,000 is
2 nontaxable.

3 Senator Heinz. John, the income doesn't go to the
4 beneficiary. To the extent there is any income, it either
5 goes to the benefit of the nonprofit organization which
6 doesn't pay taxes, or it goes to the benefit of a for-profit
7 organization which, if it makes money, does pay taxes.

8 Senator Chafee. Yes. The Marriott Corporation is going
9 into these, for example. Presumably, that will be a
10 profitable or a seeking profit organization.

11 Whereas the fellow who doesn't do this, who has his
12 money on deposit, is living at home, elderly, make him 85,
13 make her a widow --

14 (Laughter)

15 Senator Chafee. With arthritis --

16 (Laughter)

17 Senator Chafee. Her money at \$90,000 is taxable for
18 her to support herself. Now, I don't know why we treat these
19 two groups differently.

20 One -- this fit person who is in the life-care facility,
21 a 65-year-old fit male -- has his money there where he can
22 withdraw it, and the money is going to pay for his expenses.

23 And indeed, what is a life-care facility? Surely, these
24 are going to get-- We are all used to the Masonic home.

25 That is where I used to come in touch with these life-care

1 facilities, but now they are getting far more extended.

2 And pretty soon there is going to be a restaurant
3 attached to it and a country club and everything else, and
4 Marriott is going to do a really fine job.

5 So, you are treating two people with exactly the same
6 ability to withdraw their money completely different. One
7 is taxable -- the widow is taxable on her money -- and the
8 other person in these facilities is not.

9 I have trouble understanding why this should pertain,
10 that difference. If the money were nonrefundable, that is
11 different. That is understandable, but in this situation
12 where it is refundable, I don't quite see why they should be
13 treated differently.

14 The Chairman. Senator Matsunaga?

15 Senator Matsunaga. Mr. Chairman. But if this 80-year-old
16 woman with diabetes -- did you say? -- and a widow decides to
17 sell her home in which she now lives, then under Section 121
18 of the Internal Revenue Code, she can get a one-time
19 exclusion from income tax up to \$125,000 of gain.

20 She could then go into one of these lifetime-care
21 residences and then enjoy the same benefits. So, there is
22 really no difference.

23 And I wish to speak in strong support of the Heinz
24 amendment because the distinguishing feature of life care is
25 that it is a program whereby a resident enters into a lifetime

1 contract which guarantees long-term nursing care at an
2 affordable price by spreading the risk associated with the
3 high cost of such care across the whole continuing care
4 community.

5 And the specific income tax problem relates to refundable
6 life-care entry fee. Section 7872 of the Internal Revenue
7 Code treats a resident for income tax purposes as having
8 received interest income with respect to a refundable entry
9 fee.

10 Accordingly, the life-care resident is taxed on
11 nonexistent income.

12 And then the President's 1985 Economic Report, as well
13 as the study just released by the Department of Health and
14 Human Services, emphasized the important role that the
15 life-care concept can play in providing cost-effective
16 health care to elderly persons and reducing national Medicare
17 and Medicare expenditures.

18 Now, I think as lawmakers, especially in the tax field,
19 we should strive towards desirable economic goals, and I
20 think life-care under this proposal is an objective which
21 is socially desirable, especially in light of the fact that
22 this is going to really save the Federal Government
23 expenditures in the area where we are very much concerned,
24 that is the high cost of Medicare and Medicaid.

25 The Chairman. Senator Dole had a question and then

1 Senator Bentsen.

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1 Senator Dole. I would just like to ask the staff a
2 question. Is this in the President's plan?

3 Mr. Rollyson. Is this proposal in the President's plan?
4 No, sir, Senator.

5 Senator Dole. We agreed to grandfather existing
6 residents last years, but it seems to me that we are doing
7 the very thing that we have all been saying in speeches we
8 were opposed to.

9 Now can I get a no interest loan for my church to
10 repair the roof? Can the alumni get a no interest loan at
11 the college for scholarships?

12 I mean why should we make an exception here to
13 accommodate some big business interest and not make it
14 apply across the board?

15 Mr. Rollyson. Well, that's exactly right, Senator. I
16 would like to echo what Senator Chafee said. That the
17 effect of this amendment is simply to permit certain tax-
18 payers to pay for their living costs out of pretaxed dollars
19 where the great majority of all taxpayers, and everyone else,
20 has to pay their living costs out of after-tax dollars.

21 In the current legislation, in 7872, it would only
22 affect these transactions, if, indeed, they are tax motivated.
23 So it is only when there is a tax benefit that is derived
24 from these transactions that the current 7872 would come
25 into play. So we certainly oppose this amendment.

1 The Chairman. Senator Bentsen.

2 Senator Bentsen. Mr. Chairman, it's been stated here
3 that this is good social policy for the elderly. It seems
4 to me it's good social policy for the elderly if they have
5 \$100,000.00 and not for those below that.

6 Mr. Rollyson. That's correct.

7 Senator Bentsen. And what you are talking about here --
8 and to say that the elderly that takes advantage of it is
9 not the beneficiary, I don't understand that at all.
10 Obviously, it flows through to that beneficiary with less
11 charges to them.

12 Now if we want it as good social policy, why don't we
13 do something about Medicare or do something about a larger
14 credit for the elderly. But I do think this adds to the
15 complexity of the tax law, and I think it certainly deals
16 in favoritism for those that have sufficient funds to do it
17 and denied to the other.

18 I think Senator Chafee and Senator Dole have made some
19 very good points. And I certainly oppose the amendment.

20 Senator Matsunaga. Would the Senator yeild on that
21 point? The Senator raises the question that we should do
22 something about Medicaid. Well, I may put this question to
23 staff.

24 The amendment will actually result in a very minimal
25 revenue loss, will it not?

1 Senator Dole. Initially.

2 Mr. Rollyson. We do not have the revenue loss. I do
3 not. Maybe the Joint Committee does.

4 Mr. Brockway. Senator, our estimates are if it is
5 limited solely to life care facilities and doesn't extend
6 to purely nursing home facilities, it would be roughly
7 \$50 million over the period.

8 Senator Matsunaga. And that loss, if any, will be
9 offset by reductions in Medicaid expenditures and by
10 additional tax revenue generated by the creation of new
11 continuing care communities, will it not?

12 Mr. Brockway. On the Medicare, I'm really not qualified
13 to comment on that. I know that representatives of the
14 life care facilities have suggested that this might have
15 some effect, but really I don't know.

16 In terms of increased business activity, I think our
17 assumption is that if there is going to be a certain amount
18 of activity in the economy and if you take the resources
19 into life care facilities, you would just be taking them out
20 of some other area of the economy.

21 Senator Matsunaga. Right. Well, as a matter of fact,
22 the answer is obvious, isn't it? When you take otherwise
23 Medicare patients out of that system, putting them into
24 life care centers, then, of course, you reduce the cost of
25 Medicaid.

1 The Chairman. Further discussion on the Heinz
2 amendment?

3 Senator Heinz. Mr. Chairman, I would like to respond
4 to Senator Bentsen. There is an issue here that I think
5 somehow people have lost track of. It's not that someone
6 isn't going to pay taxes on whatever is earned from this
7 money.

8 I think I could make -- I'm not going to try -- but I
9 think I could make a plausible argument that the government
10 where Marriott Corporation and for-profit entities is
11 concerned is actually going to make more money off this
12 amendment than if we don't have it. That's because the tax
13 rate of Marriott is present law 46 percent, tax reform
14 38 percent. And the average tax rate of people who are
15 retired in these communities, either now or in the future,
16 is not going to be anything like that. That is not going to
17 be their marginal rate.

18 So I really think it's specious to argue that this is
19 some kind of big revenue loser.

20 The question, I submit, is whether we want to encourage
21 life care facilities or not. If we don't, fine. Vote
22 against the amendment. If we do, vote for it.

23 I must tell you that I think everybody ought to think
24 about the other kinds of issues that are like this so that
25 you can decide whether you want to be consistent or

1 inconsistent on them. We are going to have a decision on
2 whether or not we want to tax under tax reform the inside
3 build-up on life insurance. Maybe we do and maybe we don't.
4 I don't think I do. I want to encourage that kind of savings
5 for the future.

6 But those are the kinds of choices we are really talking
7 about here. Yes, I think Lloyd is right it is a social
8 choice. I would only say, Lloyd, first this is capped at
9 \$90,000.00. It applies from zero to \$90,000.00. Not from
10 \$90,000.00 on up. And there are a lot of these facilities
11 that charge you \$20,000.00 or \$30,000.00 or \$40,000.00 where
12 people, literally, they sell their home, they take all the
13 equity they have in it, and that is, in effect, where they
14 get their deposit. It's their savings of a lifetime from
15 their home and they are really transferring residences.

16 To the extent that people are going to join life care
17 communities for tax avoidance purposes, as I guess somebody
18 suggested, that really alludes me. I don't think you sell
19 your home; I don't think you cut your umbilical cord and
20 then cast yourself unknowingly and leaving yourself to
21 chance just to go into some kind of tax avoidance scheme
22 involving a life care community.

23 The Chairman. Further discussion on the Heinz amendment?

24 Senator Bradley. Mr. Chairman?

25 The Chairman. Bill.

1 Senator Bradley. I'd like to know what -- how many
2 life care communities are there? What's the number we are
3 talking about here?

4 Mr. Brockway. It really depends upon your definition.
5 There is somewhere in the range of about 275 from a narrow
6 definition up to about 600. For revenue estimating
7 assumptions, we are assuming the smaller number of about 275
8 life care that would fit in the definition that Senator
9 Heinz is talking about, about a facility that is both
10 retirement and then progressive nursing care as a person
11 gets --

12 Senator Bradley. And how many people does that affect?

13 Mr. Brockway. There's about 250 people per establishment
14 so about 75,000 people, I think.

15 Senator Chafee. Mr. Chairman.

16 The Chairman. I don't think Senator Bradley is done
17 yet.

18 Mr. Brockway. But the revenue involved here, that's of
19 all extended care facilities or life care facilities. That
20 the revenue is really only about 10 percent of those. Those
21 that have refundable deposits. Those where you make a
22 deposit that is not refundable, they are not affected by this
23 amendment. In that situation, there is no imputed interest.
24 So we are only talking about those life care facilities that
25 fund themselves through a deposit of a substantial amount of

1 money up front, but it is refundable if you decide to back
2 out.

3 Senator Bradley. And you say that is 10 percent of
4 what? Ten percent of the 275 of these communities?

5 Mr. Brockway. Facilities, yeah.

6 Senator Bradley. We are talking about 27 facilities?

7 Mr. Brockway. In that order, yes.

8 Senator Bradley. And what would you say -- it's
9 250 times 27, right? That's how many people we are talking
10 about here?

11 Mr. Brockway. That's correct.

12 Senator Dole. Fifty million.

13 Senator Bradley. Fifty million?

14 Senator Dole. Dollars.

15 Senator Bradley. Wait a minute. It's 27 times 250.
16 That's the number of people.

17 Senator Dole. I'm talking about the number of dollars.

18 Senator Bradley. But you say \$50 million. There is
19 something that doesn't work out here. If it's 27 times
20 250 and it's \$50 million, that's quite a lot of money.

21 Senator Heinz. That estimate is off the wall.

22 Mr. Brockway. Well, you've got additions every year.
23 Right now you have the 275. Then you have got additions
24 going on line each year. I think they are projecting about
25 a 6 percent growth. And in each one of these facilities, the

1 deposits are up to, under this amendment, up to \$90,000.00
2 you would have in for each one of those facilities. We are
3 talking several thousand people each year coming on,
4 making interest free loans of from between \$50,000.00 and
5 \$90,000.00.

6 Senator Bradley. What was the average income of some-
7 body in these communities?

8 Mr. Brockway. Well, we are not entirely sure about it.
9 It's obviously middle income. At some point, there's going
10 to be a requirement that you have some substantial deposit
11 of, say, \$50,000.00 to \$90,000.00, in that range, to get
12 into it. As I understand it, by and large these are people
13 who are selling an existing home and so that is where they
14 have the revenue.

15 And the people that we have discussed, and the areas,
16 suggests that they are not very well-to-do people. That they
17 are middle income people. That is what they have told us.
18 They didn't have a survey that tied that down exactly.

19 Senator Heinz. Mr. Chairman, I would like, with my
20 friends' permission, to put into the record at this point a
21 chart that explains the estimated revenue impact.

22 (THE CHART FROM SENATOR HEINZ FOLLOWS:)
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1 Senator Heinz. And if you assume the 6 percent gross
2 rate that Mr. Brockway has indicated and you use the
3 definition that we use in the legislation, you will have
4 about 287 life care projects in 1988. That will be about
5 total residents new since as of today 15,730, assuming an
6 average new entry fee over this period for everything that
7 happens over the next three years -- you would have
8 \$944,000.00 worth of fees. Of that only 10 percent would be
9 the refundable kind of fee or about \$94,000.00. What we are
10 talking about, imputed interest income on that, say, 10
11 percent, would be \$9.4 million. And the net imputed
12 taxable income on that, if you assume that the prepaid
13 medical expense deduction would be one-third of monthly
14 payment, would be \$4.7 million. And the taxes on that would
15 be less than \$1 million -- \$940,000.00 a year. That is a
16 far cry from --

17 Mr. Brockway. Well, we've been through those numbers
18 with the Marriott people, Senator, and I think that we don't
19 agree with their methodology of getting the ultimate numbers.

20 I don't think there will be a medical deduction offset
21 as --

22 Senator Heinz. Well, in that case, you've got --

23 Mr. Brockway. Each year you have this increment of
24 new life care facilities coming on line so the first year,
25 if it's 27, then the next year you have those 27 and another

1 27 and so on and so forth. It builds up over the period.
2 And you also have people in existing life care facilities,
3 the 275, on that assumption that will have some turnover.

4 And the grandfathered personnel now are just people
5 that are in the life care facilities until the -- well, the
6 new entrances in those facilities would also qualify under
7 this amendment.

8 Senator Heinz. But we are assuming a 15 percent annual
9 turnover in the existing facilities, the residents. Excuse
10 me, 5 percent.

11 Senator Durenberger. Mr. Chairman?

12 The Chairman. Senator Durenberger.

13 Senator Durenberger. Mr. Chairman, I'm not going to
14 support the amendment. I think it's terrific policy. I
15 think it's the start of long-term care insurance. And I'm
16 afraid when I hear us raising these socio-economic income
17 level arguments that we might destroy a good thing.

18 I think John and the life care people are on absolutely
19 the right track. I'm not going to support it here because
20 it's not revenue neutral and it doesn't -- I don't think it
21 belongs on this bill.

22 I think it deserves a heck of a lot more discussion and
23 a lot more illumination because we have a lot to learn from
24 this concept. And I think we ought to take the time.

25 The Chairman. Is the committee ready to vote?

1 Senator Matsunaga. One point, Mr. Chairman.

2 It seems that this proposal is being pictured as one
3 which would favor the rich and rich only. And yet I think
4 Mr. Brockway made a very good point that this would be
5 primarily for the middle income people and normally the
6 residents in a life care center would be those that would
7 sell their home and then move into these life care centers.
8 And under present law, of course, we do provide \$125,000.00
9 capital gain exemption so that we would be, in effect,
10 treating these residents on the same basis practically.

11 And, also, we speak about Medicare as a program which
12 should be limited to those in need. And more and more we
13 are thinking in terms of providing care under Medicaid for
14 those in need.

15 And here we are taking those out of the category of
16 need to provide for themselves. And this, I think, in view
17 of the fact that it would be so minimal in revenue losses,
18 should be adopted.

19 The Chairman. I know John has got to leave for a
20 commencement pretty quick.

21 Senator Chafee. One minute. Mr. Chairman, what this
22 amendment does is it treats two people in the same situation
23 differently. One person has a savings account and, indeed,
24 receives the income or the use of the income for his living
25 expenses tax free. The other person has to use after tax --

1 is she's living in her own home or living with her children,
2 having sold her home, invested the money, living with her
3 children, has the money in a savings account, she has to
4 use that money with after tax dollars. And it's an unfair
5 proposal.

6 Senator Heinz. Mr. Chairman, just on this. I probably
7 shouldn't say anything, but when I hear my friend Chafee
8 saying it treats people different under different
9 circumstances --

10 Senator Chafee. No. Under the same circumstances.

11 Senator Heinz. Same circumstances. The present law
12 treats people differently under the same circumstances. If
13 it's a non-refundable deposit, there's no problem. If it's
14 a refundable deposit, which I think you want to -- I would
15 argue is a good consumer thing to have and it keeps the
16 operators honest -- you get taxed.

17 Thank you.

18 The Chairman. Clerk, call the roll on the Heinz
19 amendment.

20 The Clerk. Mr. Dole.

21 Senator Dole. No.

22 The Clerk. Mr. Roth.

23 Senator Heinz. Aye, by proxy.

24 The Clerk. Mr. Danforth.

25 (No response)

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

1 Senator Baucus. Aye, by proxy.

2 The Clerk. Mr. Bradley.

3 Senator Bradley. No.

4 The Clerk. Mr. Mitchell.

5 Senator Mitchell. No.

6 The Clerk. Mr. Pryor.

7 (No response)

8 The Clerk. Mr. Chairman.

9 The Chairman. Aye.

10 The Clerk. Eight yeases, seven nays.

11 The Chairman. The amendment is adopted.

12 Senator Chafee.

13 Senator Chafee. I have an amendment that every elderly
14 person with \$90,000.00 in a savings account can receive all
15 the income from that savings account tax free if the money
16 shall be used for his or her living expenses.

17 May I ask for a roll call?

18 The Chairman. Clerk, call the roll.

19 Senator Bradley. What is this?

20 (Laughter)

21 Senator Chafee. It's exactly a repeat of the one that
22 was just approved by this committee.

23 The Chairman. Clerk, call the roll.

24 The Clerk. Senator Dole.

25 Senator Dole. No.

25 Senator Bradley. Wait a minute, wait a minute. What is

1 this amendment?

2 Senator Chafee. First \$90,000.00 in a savings accounts,
3 the income can be received tax free for living expenses by
4 the elderly person. Over 65. Old enough to get into a
5 Marriott Corporation life care facility.

6 (Laughter)

7 The Chairman. Clerk will continue to call the roll.

8 The Clerk. Mr. Roth.

9 (No response)

10 The Clerk. Mr. Danforth.

11 (No response)

12 The Clerk. Mr. Chafee.

13 Senator Chafee. Aye.

14 The Clerk. Mr. Heinz.

15 (No response)

16 The Clerk. Mr. Wallop.

17 (No response)

18 The Clerk. Mr. Durenberger.

19 Senator Durenberger. No.

20 The Clerk. Mr. Armstrong.

21 Senator Armstrong. No.

22 The Clerk. Mr. Symms.

23 Senator Symms. Aye.

24 The Clerk. Mr. Grassley.

25 Senator Grassley. No.

1 The Clerk. Mr. Long.
2 (No response)
3 The Clerk. Mr. Bentsen.
4 Senator Bentsen. No.
5 The Clerk. Mr. Matsunaga.
6 Senator Matsunaga. No.
7 The Clerk. Mr. Moynihan.
8 (No response)
9 The Clerk. Mr. Baucus.
10 Senator Baucus. No.
11 The Clerk. Mr. Boren.
12 (No response)
13 The Clerk. Mr. Bradley.
14 (No response)
15 The Clerk. Mr. Mitchell.
16 Senator Mitchell. No.
17 The Clerk. Mr. Pryor.
18 (No response)
19 The Clerk. Mr. Chairman.
20 The Chairman. No.
21 The Clerk. Two yeas and nine nays.
22 The Chairman. Are there other amendments?
23 Senator Dole. Yes, Mr. Chairman.
24 The Chairman. Senator Dole and then Senator Durenberger.
25 Senator Dole. I wanted to raise at this point that it

1 was brought to my attention that the Ways and Means Committee
2 bill would change the method of establishing the applicable
3 rates so that it would fluctuate monthly. And this would
4 apply both for the imputed interest, OID rules and for
5 no interest/slow interest loan rules.

6 I think this is basically a good change. There will be
7 less time delay if interest rates fall. But it does create
8 one problem. And that problem is where the employer provides
9 a mortgage for relocated employees. The employer cannot
10 guarantee that a rate that satisfies the rule at the time
11 an employee makes an offer on a house will satisfy that
12 requirement 60 or 90 days later.

13 As I understand, the Joint Tax and Treasury has no
14 problem with the modification. It would seem to me that
15 this would give an employer a problem if he wants to state
16 adequate interest rates on a mortgage loan to relocate an
17 employee that he couldn't tell the employee what the interest
18 rates might be in 60 to 90 days.

19 And I think the staff from the Joint Committee and
20 Treasury have looked at a possible modification. They have
21 no objections to it.

22 Mr. Rollyson. I think that's right, Senator, if I
23 heard you correctly. It would be from when the offer on the
24 house was made or a similar fact.

25 Senator Dole. Correct. And it's also been discussed --

1 The Chairman. Excuse me. I didn't hear what you said
2 after they responded.

3 Mr. Colvin. That's correct.

4 Senator Dole. I think it's been cleared by Treasury.
5 We talked to staff about it. I think the Joint Tax
6 Committee has no problem.

7 The Chairman. Without objection.

8 Senator Bradley. Mr. Chairman.

9 The Chairman. Senator Durenberger was next.

10 Senator Durenberger. Mr. Chairman, I will be brief. I
11 don't know that we would have a bill before us today in the
12 form that it is in if we hadn't had the debate we had on the
13 floor last summer over the imputed interest legislation that
14 came out of the conference committee.

15 We sat here for many weeks writing up a tax bill and
16 never got to this subject. And all of a sudden we discovered
17 that the Treasury and IRS had persuaded the Conference Com-
18 mittee to put a 14.3 percent rate of interest on every piece
19 of seller financing that was done in this country.

20 And, obviously, the realtors and others reacted to that,
21 but so did a lot of farmers in my state who have -- in my
22 state, I just want you to know you don't have to be as
23 sympathetic as you are to old ladies with diabetes, but the
24 equity in farmland in my state is 50 percent today of what it
25 was two and a half years ago.

1 And I know that's true from Texas to Minnesota. And I
2 don't know how far East and West it goes.

3 It is a hell of a time out there, frankly. And a lot
4 of this reaction came from bankrupt people who, potentially
5 bankrupt people, who couldn't sell at these kinds of rates
6 of interest.

7 So I just have to refortify that as a rationale for
8 what we are doing here today, Mr. Chairman.

9 I offered S. 30, 32 last summer as an alternative to
10 that John Melcher and other things that were taking place
11 on the floor. And I think this hearing system that we are
12 now in, and the 9 percent under \$2 million, comes from that
13 so I have some small amount of pride of authorship.

14 Two of the areas that ought to be done on this bill and
15 that are not being done -- one is to adopt the current
16 blending between \$2 million and \$4 million that's in the
17 current stopgap legislation to the bill that's before us
18 so that we can have a blend in the area between \$2 and \$4
19 million on the interest rate. That is a straight blending
20 of 9 percent and 100 percent would be a lot simpler for
21 people to work with and it would protect people just over
22 the \$2 million line from losing the benefit.

23 And the other is the issue of the wrap-around mortgage.
24 And I talked to Ron Pearlman about this yesterday. And I
25 know we haven't decided tax treatment generally about

1 wrap-arounds, and I know he's apprehensive about installment
2 sales, and I have an amendment which would apply the
3 coverage of this bill to wrap-around mortgages. But would
4 limit it to imputed interest and OID rules alone, and not
5 get into installment sales.

6 Those are my two amendments. But my problem is this,
7 Mr. Chairman. That within the last 24 hours I have received
8 revenue estimates from Joint Tax on my two amendments which
9 total \$300 million. And I respect the desire of the majority
10 of the members of this committee to report this bill out as
11 a revenue neutral bill. I respect the action that the House
12 of Representatives took when it sent this bill over to us
13 to keep it revenue neutral.

14 So in that sense of comedy, I feel compelled, even
15 though my predecessor didn't feel compelled to do it -- he
16 had a smaller amount, \$50 million, so I feel compelled not
17 to put my amendments up.

18 But I would like to suggest to the Chairman or I would
19 move that the revenue models used by the Joint Tax Committee
20 to estimate revenue gain or loss from this bill and from my
21 two proposed amendments to the bill be included in the
22 report of the Finance Committee to the Senate on this bill.

23 Mr. Chairman, let me say this. That is not intended in
24 any way to reflect on the Joint Tax Committee, on Dave, on
25 the estimators or anybody else. It is intended to say that

1 we ain't seen nothing yet from what we are going to see in
2 the next two months. And the revenue estimators are king
3 now in this whole process. And if they ain't good, they
4 at least are going to be making policy.

5 We aren't going to be able to make policy. The
6 President said everything has got to be revenue neutral.
7 You've endorsed it. We've all endorsed the concept of
8 revenue neutrality.

9 That means the revenue estimates -- and you all know
10 how these things work in a mark-up -- the revenue estimates
11 can kill or pass a piece of legislation. And so I just want
12 to acknowledge at this point my respect for you, the
13 committee, to Dave, and the folks that have to do the
14 estimating, and to sort of warn you ahead of time that there
15 is going to be a lot of pressure on the revenue estimating
16 process to make sure --

17 The Chairman. I don't know if you realize the
18 magnitude when Jim Baker says, well, the bill is close to
19 revenue neutrality. Eleven billion dollars off. But that's
20 only .24 percent of the total amount and you are estimating
21 \$800 or \$900 billion over several years. Well, my gosh, you
22 can be off plus or minus 10 percent on that and you are off
23 a swing of \$200 billion. But that's close enough for
24 government work.

25 (Laughter)

1 Senator Symms. Would the Senator yield.

2 The Chairman. Steve.

3 Senator Symms. Mr. Chairman, I would just like to
4 second what Dave Durenberger said.

5 As one member of this committee, I totally object to
6 this worshipping at the shrine of revenue neutrality based
7 on static Treasury numbers. We need a better system to
8 estimate these numbers because the Treasury bureaucrats and
9 statisticians and so forth cannot -- and I don't say this
10 critically of them personally, but there is no way they can
11 apply what will be the market response. And people do
12 respond to incentives. And we are totally, I think, going
13 to miss -- you know, we are making a mistake. I think we
14 ought to pass the Durenberger amendments here this morning.
15 I'd urge the Senator to offer them because I don't believe
16 that the numbers that --

17 The Chairman. By the way, Dave, we will put those in
18 the report. I should have said so as soon as you finished.

19 We can do one or two things. You can go by some
20 numbers, somebody's, or you go by no numbers and just say,
21 oh, well, something will happen.

22 Senator Symms. I don't mean to make a statement here
23 that sounds as though I'm not concerned about the deficit
24 because I am, but that is another problem. That's a spending
25 problem. We spend too much money.

1 And the estimates on Treasury, we should be making good,
2 sound tax policy based on human behavior and how people
3 respond to incentives -- savings incentives and so forth.
4 I voted for the Chafee \$90,000.00 IRA for senior citizens.
5 I think it would probably be good tax policy.

6 The Chairman. Let me see if we can finish up this
7 bill first.

8 Senator Symms. And that, probably, would generate
9 revenue.

10 The Chairman. Bill, you've got a clarifying amendment.

11 Senator Bradley. Did you want me to reconsider the
12 vote, Senator?

13 Senator Chafee. Do we --

14 Senator Bradley. I don't have an amendment. I simply
15 have a clarification. I would like to ask maybe staff, maybe
16 Mr. Wilkins about Section 4 of the House bill on imputed
17 interest.

18 I think that what has happened is kind of unintentional
19 misapplication of the provisions. And I wonder if you
20 could --

21 Mr. Wilkins. This section in the House bill authorizes
22 Treasury in appropriate circumstances to provide a rate
23 lower than the applicable federal rate, if that is proved
24 to be appropriate to the satisfaction of the secretary. It's
25 not clear in the House bill whether the Treasury would have

1 authority to apply this to transactions beginning with the
2 effective date of the 1984 Act or just with the effective
3 date of this particular bill.

4 I think the lack of clarity -- that Senator Bradley
5 would seek to clarify that. That Treasury authority could
6 apply as if included in the 1984 Act since we are talking
7 about --

8 Senator Bradley. Which is when the bill was passed.

9 Mr. Wilkins. Right. Which is when the original bill
10 was passed.

11 The Chairman. Right.

12 Senator Bentsen. Does Treasury ever exercise that
13 authority?

14 Mr. Wilkins. Well, the authority would be granted in
15 the imputed interest bill that the committee is considering
16 today.

17 Senator Bentsen. It's --

18 Mr. Wilkins. It's a question of whether they will do
19 it.

20 Mr. Rollyson. Senator Bentsen, we have not as yet
21 exercised that authority. The regulations have not been
22 promulgated yet. But we do expect to carve out certain
23 instances in which we will provide for a lower rate than
24 the published applicable federal rate.

25 The Chairman. If there are no other objections, I will

1 ask the Clerk to call the roll on the bill.

2 Senator Chafee. Mr. Chairman, we are ready to vote on
3 the bill?

4 The Chairman. Yes.

5 Senator Chafee. I would like to make just one quick
6 amendment. And I won't ask for a roll call, just a show of
7 hands.

8 I would move to eliminate all reference to indexing
9 here. Indexing is bad business. And if we want to change
10 it later, we can revisit it. And I won't ask for roll call,
11 just a show of hands or something.

12 The Chairman. You don't want a roll call. You don't
13 even want a vote. You just want a show of hands as to --

14 Senator Chafee. Oh, I want a vote, sure I want a vote,
15 but not a roll call vote.

16 The Chairman. You want to eliminate all references to
17 indexing in the code?

18 Senator Chafee. No, no, no.

19 (Laughter)

20 Senator Chafee. Well, I'd do that too, but I'm just
21 taking this act here that we have before us, the simplifica-
22 tion provisions before the House. And they have a series of
23 indexing. Indexing the dollar amounts in Section 1, which is
24 the test rates. Section 2 is the test rates for large
25 transactions.

1 The Chairman. You want a show of hands on eliminating
2 all references to indexing in the imputed interest bill
3 before us?

4 Senator Chafee. Right, right.

5 The Chairman. All those in favor of eliminating,
6 raise their hand?

7 (Showing of hands)

8 The Chairman. Those opposed?

9 (Showing of hands)

10 Senator Bentsen. Let me say, if I may. You know, I
11 might be for you, but to bring it up at the last minute
12 without really having a full understanding of its impact.
13 I might very much support it because I frankly don't like
14 indexing.

15 Senator Chafee. Well, I just thought, Mr. Chairman --
16 the reason I didn't spend more time on it is that you --

17 Senator Baucus. You don't have the votes.

18 (Laughter)

19 Senator Chafee. That was one of the reasons. That
20 was the major reason, yes.

21 The Chairman. Clerk will call the roll on reporting
22 the bill out.

23 The Clerk. Mrs. Dole.

24 Senator Dole. Aye.

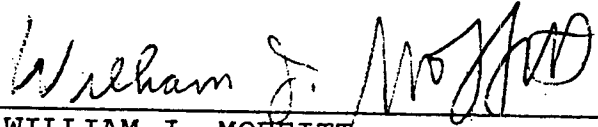
25 The Clerk. Senator Roth.

1 (No response)
2 The Clerk. Mr. Danforth.
3 (No response)
4 The Clerk. Mr. Heinz.
5 Senator Heinz. Aye.
6 The Clerk. Mr. Wallop.
7 Senator Baucus. Aye, by proxy.
8 The Clerk. Mr. Durenberger.
9 Senator Durenberger. Aye.
10 The Clerk. Mr. Armstrong.
11 Senator Armstrong. Aye.
12 The Clerk. Mr. Symms.
13 Senator Symms. Aye.
14 The Clerk. Mr. Grassley.
15 Senator Grassley. Aye.
16 The Chairman. Mr. Roth and Mr. Danforth aye also.
17 The Clerk. Mr. Long.
18 (No response)
19 The Clerk. Mr. Bentsen.
20 Senator Bentsen. Aye.
21 The Clerk. Mr. Matsunaga.
22 Senator Matsunaga. Aye.
23 The Clerk. Mr. Moynihan.
24 (No response)
25 The Clerk. Mr. Baucus.

1 Senator Baucus. Aye.
2 The Clerk. Mr. Boren.
3 Senator Baucus. Aye, by proxy.
4 The Clerk. Mr. Bradley.
5 Senator Bradley. Aye.
6 The Clerk. Mr. Mitchell.
7 Senator Mitchell. Aye.
8 The Clerk. Mr. Pryor.
9 Senator Pryor. Aye.
10 The Clerk. Mr. Chairman.
11 The Chairman. Aye. And Mr. Moynihan aye.
12 The bill is reported.
13 (Whereupon, at 11:13 a.m., the Executive session was
14 concluded.)
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C E R T I F I C A T E

This is to certify that the foregoing proceedings of a hearing before the United States Senate, Committee on Finance, Executive Session, Thursday, June 6, 1985, were held as herein appears and that this is the original transcript thereof.


WILLIAM J. MOFFITT
Official Court Reporter

My Commission Expires April 14, 1989

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MR PACKWOOD - CHAIR, MR SYMMS, MR CHAFEE, MR HEINZ, MR GRASSLEY,
MR ARN-STRONG, MR MITCHELL, MR BORAH, MR MATSUOKA, MR PRIOR,
MR BENTEN, MR BAUCUS, MR DURENBERGER, EXECUTIVE SESSION
MR DOLZ, MR BRADLEY, 99th Congress, 1st Session
June 6, 1985

SENATE COMMITTEE ON FINANCE

EXECUTIVE SESSION

Thursday, June 6, 1985; 10:00 a.m.; Room SD-215

1. Nomination of Robert Kimmitt, to be General Counsel of the Treasury (Anne Cantrel)
2. Simplification of Imputed Interest rules (H.R.2475)

Symms Amend. -

HEINZ AMEND LIFE CARE

ADOPTED

CHAFEE 1

NO

DURENBERGER

STAFF - COLVIN MORAN STERN WILKINS BROCKWAY KAYLA ROLLYSON MERTZ

A. BIOGRAPHICAL INFORMATION

1. Name: Robert Michael Kimmitt
2. Address: 524 North Oxford Street
Arlington, VA 22203
3. Date and place of birth: December 19, 1947
Logan, Utah
4. Marital status: Married
Wife: Holly Sutherland Kimmitt
5. Names and ages of children: Kathleen W. Kimmitt 5yrs
Robert M. Kimmitt, Jr. 3yrs
William P. J. Kimmitt 1 1/2 yrs
Thomas M. Kimmitt 1 month

6. Education:

Georgetown University Law Center	Washington, DC	1974 to 1977	J.D.
Oklahoma University	Norman, OK	1972 to 1973	(Soviet/Chinese Studies)
U.S. Military Academy	West Point, NY	1965 to 1969	B.S.
O'Connell H.S.	Arlington, VA	1964 to 1965	H.S. Diploma

7. Employment record:

7/78 to present	Nat'l Security Council Robert C. McFarlane (1983-85) William P. Clark (1981-83) Richard V. Allen (1981) Zbigniew Brzezinski (1978-81)	White House, Executive Wash, D.C. Secretary and General Counsel and Deputy Assistant to the President for National Security Affairs
8/77 to 7/78	Judge Edward Allen Tamm	Wash, D.C. Law Clerk
6/76 to 8/77	NSC, Brent Scowcroft	Wash, D.C. Staff Member
9/74 to 5/77	US Army	G'town Law Ctr Student
6/73 to 8/74	US Army	Ft Campbell, KY Gen Staff Ofc
7/72 to 5/73	US Army	Ft Sill, OK Student
9/71 to 6/72	US Army	Ft Campbell KY Unit Cmdr
4/70 to 8/71	US Army	Vietnam Unit Cmdr
12/69 to 3/70	US Army	Ft Benning GA Student
7/69 to 11/69	US Army	Ft Sill OK Student

8. Government Experience:

Same as above.

9. Memberships:

Association of Graduates USMA, West Point, NY
Society/173rd Abn.Bde. Fayetteville, NC
American Bar Assn. Chicago, Ill.
D.C. Bar Washington, DC

10. Political affiliations and activities: None

11. Honors and awards: Three Bronze Star Medals
Purple Heart
Air Medal
Vietnamese Cross of Gallantry
Distinguished Honor Graduate of
Jumpmaster and Ranger courses

12. Published Writings: None, other than internal White House,
National Security Council, and Federal
Court memoranda.

13. Speeches: None, other than remarks (no written text)
on the NSC System to various groups

14. Qualifications: Seven years as chief legal officer for the
National Security Council (the last four
as General Counsel), preceded by a
one-year federal clerkship on the
D.C. Circuit Court of Appeals.

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United States Senate

COMMITTEE ON FINANCE
WASHINGTON, DC 20510

WILLIAM DIEFENDERFER, CHIEF OF STAFF
MICHAEL STERN, MINORITY STAFF DIRECTOR

June 4, 1985

MEMO

FROM: TAX STAFF

TO: SENATE FINANCE COMMITTEE

SUBJECT: EXECUTIVE SESSION TO CONSIDER IMPUTED
INTEREST LEGISLATION

On Thursday, June 6, at 10:00 a.m., the Senate Finance Committee will meet in Executive Session to consider legislation providing for simplification of imputed interest rules.

The attachment describes H.R. 2475, the imputed interest bill approved by the House of Representatives on May 24, 1985.

BACKGROUND

The Tax Reform Act of 1984 provided restrictions on interest rates and accounting methods for seller financing. In October, 1984 Congress enacted stopgap provisions to give temporary relief from the interest rate provisions of the 1984 Act for seller financing up to \$2 million (P.L. 98-612). These provisions expire July 1, 1985.

June 4, 1985

SIMPLIFICATION OF IMPUTED INTEREST RULES
AREAS FOR SENATE FINANCE COMMITTEE CONSIDERATION

PROVISIONS OF H.R. 2475

A. SIMPLIFICATION AND REDUCTION OF MINIMUM INTEREST
RATES

1. Test Rates for Small Transactions. When the amount of seller financing is less than \$2 million, the test rate is the lesser of --
 - a. 9%, or
 - b. 100% of the applicable Federal rate ("AFR").
2. Test Rate for Large Transactions. When the amount of seller financing is more than \$4 million, the test rate is 100% of the AFR.
3. Blending. When the amount of seller financing is between \$2-\$4 million, the test rate is blended between the rates in 1 and 2.
4. Indexing. The dollar amounts provided in 1 and 2 are indexed beginning after 1988.

5. Elimination of Penalty Rates. The dual test rate/imputation rate structure from pre-1984 and 1984 law is repealed.

6. Inapplicability to new investment tax credit property. As in the stopgap legislation enacted in October, 1984, the 9% test rate does not apply to new investment tax credit property.

7. Monthly Interest Determination for Large Seller Financing Transactions. H.R. 2475 eliminates the six months AFR rules from the 1984 Act, and adopts the substance of temporary Treasury regulations, which --
 - a. provide for monthly determinations of the applicable federal rate, and
 - b. allow the taxpayer to use the monthly rate for that month and the two following months.

8. Lower Interest Rates in Appropriate Circumstances. The Treasury Department is authorized to issue regulations under which taxpayers may show that in appropriate circumstances an interest rate less than 100% of the AFR may be used.

9. Aggregation Rules. To prevent use of the small transactions rule in inappropriate cases, Treasury is given authority to issue regulations providing for aggregation of notes that are essentially part of a single transaction.

B. EXEMPTION OF ASSUMPTIONS FROM IMPUTED INTEREST RULES

Assumptions are exempted from the imputed interest rules. Issuance of wrap around debt would not be treated as an assumption, pending resolution of this issue for purposes of the installment sales rules.

C. ACCOUNTING FOR INTEREST IN SELLER FINANCING

1. Small Transactions. For seller financing up to \$2 million, the parties may elect cash accounting for interest on the note.
2. Limitations. This election is not available if the seller is --
 - a. a dealer in the property, or
 - b. an accrual method taxpayer.
3. Subsequent Transfers or Assumptions of the Note. Rules are provided to assure consistent accounting treatment by persons who assume

obligations under a "cash-cash" note, and to authorize Treasury to issue anti-abuse regulations.

D. REVENUE OFFSET -- CAPITAL RECOVERY ALLOWANCES
FOR REAL PROPERTY

1. Recovery Period for Real Property. To offset the revenue loss resulting from simplification of the imputed interest rules, the recovery period for real property is raised from 18 to 19 years.
2. Effective Date. This change applies to property placed in service after May 8, 1985, unless placed in service by December 31, 1986, if there was a binding contract on or construction began by May 8, 1985.
3. Low Income Housing. H.R. 2475 does not raise the recovery period for low income housing from its current 15 years.

E. REVENUE ESTIMATES

Revenue Effect
(fiscal years, \$ millions)

H.R. 2475

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>TOTAL</u>
Imputed interest provisions	-5	-58	-153	-172	-205	-235	-828
Increase recovery for real property from 18 to 19 years	+5	+30	+91	+166	+255	+344	+891
Net revenue effect	0	-28	-62	-6	+50	+109	+63