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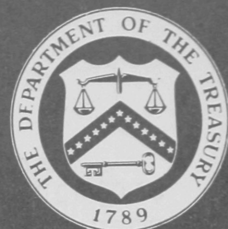


'OR RELEASE AT 4:00 P.M. April 1, 1980

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, .nvites tenders for two series of Treasury bills totaling .pproximately $6,800 million, to be issued April 10, 1980. 'his offering will provide $ 500 million of new cash for the 'reasury as the maturing bills are outstanding in the amount of 6,278 million, including $661 million currently held by 'ederal Reserve Banks as agents for foreign and international .onetary authorities and $1,470 million currently held by ederal Reserve Banks for their own account. The two series ffered are as follows:

91-day bills (to maturity date) for approximately $3,400 illion, representing an additional amount of bills dated 'anuary 10, 1980, and to mature July 10, 1980 (CUSIP No. 12793 4V 5), originally issued in the amount of $3,252 million, he additional and original bills to be freely interchangeable.

182-day bills for approximately $3,400 million to be dated .pril 10, 1980, and to mature October 9, 1980 (CUSIP No. 12793 5J 1).

Both series of bills will be issued for cash and in xchange for Treasury bills maturing April 10, 1980. Tenders rom Federal Reserve Banks for themselves and as agents of 'eign and international monetary authorities will be accepted the weighted average prices of accepted competitive tenders. litional amounts of the bills may be issued to Federal Reserve anks, as agents of foreign and international monetary authorities,) the extent that the aggregate amount of tenders for such ccounts exceeds the aggregate amount of maturing bills held by them.

The bills will be issued on a discount basis under competitive id noncompetitive bidding, and at maturity their par amount will payable without interest. Both series of bills will be issued itirely in book-entry form in a minimum amount of $10,000 and in iy higher $5,000 multiple, on the records either of the Federal serve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and anches and at the Bureau of the Public Debt, Washington, C. 20226, up to 1:30 p.m., Eastern Standard time, r day, April 7, 1980. Form PD 4632-2 (for 26-week series) Form PD 4632-3 (for 13-week series) should be used to submit nders for bills to be maintained on the book-entry records of e Department of the Treasury.

Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held at the close of business on the day prior to the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering; e.g., bills with three months to maturity previously offered as six month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

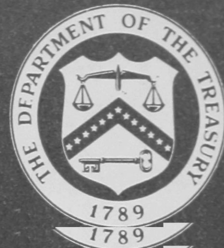
Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $500,000 or less without stated price from any one bidder will be accepted in full at the weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on April 10, 1980, in cash or other immediately available funds or in Treasury bills maturing April 10, 1980. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041



FOR IMMEDIATE RELEASE April 1, 1980

RESULTS OF TREASURY'S 80-DAY BILL AUCTION

Tenders for $4,001 million of 80-day Treasury bills to be issued on April 7, 1980, and to mature June 26, 1980, were accepted at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Price	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)
High -	96.523	15.647%	16.44%
Low -	96.498	15.759%	16.56%
Average -	96.508	15.714%	16.51%

Tenders at the low price were allotted 41%

TOTAL TENDERS RECEIVED AND ACCEPTED BY FEDERAL RESERVE DISTRICTS:

Location	Received	Accepted
Boston	$ ---	$ ---
New York	11,333,000,000	3,758,710,000
Philadelphia	---	---
Cleveland	110,000,000	---
Richmond	80,000,000	9,100,000
Atlanta	5,000,000	2,000,000
Chicago	746,000,000	162,000,000
St. Louis	33,000,000	---
Minneapolis	11,000,000	5,000,000
Kansas City	---	---
Dallas	---	---
San Francisco	622,000,000	64,000,000
TOTAL	$12,940,000,000	$4,000,810,000

An additional $25 million of the bills will be issued to Federal Reserve Banks as agents of foreign and international monetary authorities for new cash.

M-409

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For Release Upon Delivery
April 2, 1980 10:30 a.m. EST

STATEMENT OF EMIL M. SUNLEY
DEPUTY ASSISTANT SECRETARY OF THE TREASURY (TAX POLICY)
BEFORE THE
HOUSE WAYS AND MEANS COMMITTEE
ON THE
TAX TREATMENT OF MARRIED AND SINGLE TAXPAYERS

Mr. Chairman, and Members of this Committee:

The Treasury welcomes the opportunity to testify on the tax treatment of married couples and single individuals. This subject raises some of the most important issues in income tax policy and some of the most difficult to resolve. The Congress and the Executive Branch have wrestled with these issues since the establishment of the Federal income tax in 1913. The issues involve basic questions: Is the individual or the family the appropriate unit of taxation? Should the different circumstances of a family with one earner and a family with two earners be recognized? Should the special circumstance of a single person who maintains a household for children or other persons be recognized?

As it stands today, the tax law gives rise to tax increases and tax decreases when a marriage takes place and when a marriage is dissolved by reason of divorce or death. These tax consequences add to public concern about the fairness of the tax system. They also create concerns about the tax system's economic efficiency. For example, second earners among married couples and single persons are faced with greater work disincentives than are primary earners among married couples.

Equity Considerations

Tax policy has been guided by four important and widely-accepted goals in the tax treatment of the family and single individuals.

First, the income tax should be a progressive tax based on ability-to-pay. The average tax rate should rise as

income rises. A single individual with the same income as two individuals should pay more tax because that individual has more ability-to-pay. For example, more tax should be collected from a single person earning $20,000 than should be collected from two single persons earning $10,000 each.

Second, married couples with equal combined income should pay the same tax. No distinction should be made among married couples on the basis of how much of their combined income is earned by each spouse. For example, all married couples with total incomes of $20,000 should pay the same tax, regardless of whether one spouse earns all of the income or each spouse earns half or differing portions.

Third, a tax penalty should not be imposed on marriage. Two single individuals should not pay a higher tax as a result of marriage. For example, a man and woman earning $10,000 each should both pay the same tax whether they are married or single.

Fourth, a tax penalty should not be imposed on becoming or staying single. A single person should not pay more tax than another individual with equal income who is married to a spouse who has no earnings or income. Conversely, a couple should not pay higher taxes as a result of divorce. For example, a married couple with both spouses earning $10,000 each should pay the same tax as two single persons both earning $10,000.

While each of these goals is accepted as sound and fair, they conflict with one another. Any tax system will violate one or more of these goals. For example, if the second, third, and fourth goals are achieved in a tax system the tax cannot be progressive.

1. Historical Development of Current Law

The history of the tax treatment of the family and single persons provides ample evidence of this conflict. The conflict is at the root of the issues under examination in present tax law.

a. Rates. Between 1913 and 1948, the tax law recognized the individual as the unit of taxation. The tax system thus conformed with all the goals except the second, which requires the taxing of the combined incomes of the married couple. Consequently, couples with the same combined income had different tax liabilities.

Different treatment of couples with the same combined income was exacerbated by legal reallocation of property and income in "community property" States and by the ability of couples in other States to minimize taxes by reallocating

property income. In 1948, the law was changed to allow the combining of incomes and "income splitting", that is, each spouse was presumed to have an equal amount of income whether or not that was the actual case. However, as a consequence of that decision, single taxpayers were required to pay more tax than most married couples with the same income. Looked at another way, a marriage bonus was introduced into the tax system in 1948.

The single penalty introduced in 1948 was most conspicuous in the case of single taxpayers with children -- typically a widowed or divorced parent. In 1951, therefore, a special category of head of household was introduced. Tax rates for heads of household were set halfway between those of single persons and married couples. This was a compromise between the single individual's tax and the married couple's tax.

After 1948, there was a substantial tax increase for many earners who were made single due to the death of a spouse; for these taxpayers, the benefit of income splitting was immediately lost. Therefore, the law was changed in 1954 to allow a surviving spouse who maintains a household for a dependent child to continue to obtain the benefits of income splitting for two years after the year of death of the spouse. After that period, the surviving spouse followed normal rules to determine whether he or she would file as a "head of household" or a single person.

A continuing concern about the single penalty (or the marriage bonus) led to enactment of lower rates for single persons effective in 1971. Since the rates for married couples were not changed, the benefit of income splitting was effectively eliminated at most income levels. A substantial marriage penalty was introduced; many two-earner families could pay lower taxes if they were single. To prevent two-earner married couples from taking advantage of the new single person rates, married couples were required to use the pre-1971 rate schedule for single persons if they filed separate returns.

The concern about the substantial marriage penalty introduced by the 1971 legislation led to a small reduction of the marriage penalty in 1979 when new rate schedules were introduced.

These actions since 1913 reflect decisions on the unit of taxation and the applicable tax rate schedules. The issue is even more complicated because of actions with respect to other Code provisions, such as the standard deduction, the low-income allowance, the zero bracket amount, and the child care deduction and credit.

b. Other Code Provisions. Prior to the Tax Reduction Act of 1975, two single persons could claim two standard deductions or low-income allowances. If they married, however, they could claim only one. In the 1975 legislation, the low-income allowance and the maximum standard deduction allowed married taxpayers was made higher for married couples filing jointly than for single individuals. This reduced the marriage penalty but it also increased the single penalty. A single individual who married another individual with no income claimed a larger standard deduction than the amount claimed as a single individual.

In 1977, legislation repealed the standard deduction and introduced the zero bracket amount in all rate schedules. It provided that a certain amount of taxable income is subject to a tax rate of zero percent. The enactment of the zero bracket amount represented a compromise between reducing the marriage penalty and reducing the single penalty. The zero bracket amount currently is $2,300 for a single person (and head of household) and $3,400 for a married couple (and a surviving spouse). To the extent that a married two-earner couple has a smaller zero bracket ($3,400) amount than twice the single earners' amount ($4,600) there is a marriage penalty. To the extent that a married one-earner couple has a larger zero bracket amount ($3,400) than that of a single person ($2,300), there is a single penalty.

In all of these actions -- defining the tax unit, prescribing appropriate rate schedules, providing zero bracket amounts -- tax policy (since 1948) has accepted the first two goals -- progressivity and the taxation of combined incomes of married couples -- and has attempted to compromise the inconsistency between the marriage penalty and the single penalty.

As a result of these actions the Internal Revenue Code contains four different rate schedules for the individual income tax. One is for single persons, one is for married couples filing joint returns, one is for married persons filing separate returns, and one is for single persons who qualify as heads of households. Each schedule contains a "zero bracket" and positive rates ranging from 14 to 70 percent. (See Table 1.)

Some limited recognition has also been given in past legislation to certain additional costs of earning income in the case of two-earners (and also a single person) who have children. In the 1954 legislation, a limited child care deduction was made available to married couples and single persons with incomes less than $6,000. The deduction was expanded in both the 1971 and 1975 legisltation, and in the 1976 legislation, the deduction was replaced with a credit equal to 20 percent of the first $2,000 of child care

Table 1

Summary of the 1979 Rate Schedules

Schedule in Form 1040 Instructions	Taxpayers Covered	Number of Returns Using Schedule in 1979 1/	Amount of Zero Bracket in 1979
Schedule X	Single persons other than heads of households	39.6 million	$2,300
Schedule Y (part 1)	Joint returns of married couples, and certain surviving spouses	45.7 million	$3,400
Schedule Y (part 2)	Separate returns of married persons	1.4 million	$1,700
Schedule Z	Unmarried heads of households	6.3 million	$2,300

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Office of Tax Analysis

1/ Total Individual Returns, 93.0 million.

expenses for one child and the first $4,000 of such expenses for two children. The income limit also was removed. The child care credit can be viewed as a possible offset for the marriage penalty in the case of two-earner families with children. This is particularly true since the credit is not strictly limited to child care. The housekeeper often cleans the house and does the laundry. For a two-earner family without children these same costs may be incurred in order for the second earner to enter the labor force, but the costs receive no special tax benefit under present law.

That is briefly the legislative history on attempts to resolve the issues. Let's look more specifically at present law and at the dimensions of the problem.

2. Present Law

The current tax treatment reflects the progressive tax and generally taxes the combined income of husband and wife without distinction between one-earner and two-earner families, except for the child care credit. Both marriage penalties and single penalties exist in present law. Two wage earners who are married often pay more tax than they would if they were single. A single person often pays more tax than a married couple with the same income. The two-earner couple pays the same tax as the one-earner couple having the same total income. Except for the child care credit, the law ignores the additional costs incurred in earning income in the two-earner case.

a. Marriage Penalty. If two persons with independent incomes marry, they often have to pay a higher tax. For example, assume two persons each have taxable incomes of $15,000 (after subtracting their exemptions) and assume they do not itemize their deductions. If they file as single individuals, they each must pay $2,605 in tax. Their combined tax is therefore $5,210. If they marry and file a joint return, their taxable income is $30,000, and their tax (from schedule Y) is $6,238. In this case, their marriage penalty is $1,028. (See Table 2 for examples of marriage penalties for selected levels of taxable income.)

However, it is not necessary that the two individual incomes be equal in order for a marriage penalty to arise. Suppose that the two persons have taxable incomes of $22,000 and $8,000, adding up to the same combined taxable income of $30,000. Filing as single persons, their respective taxes are $4,857 and $977, for a total tax of $5,834. If they marry and file jointly, their tax is $6,238, for a marriage penalty of $404. If the income is divided more unevenly, the marriage penalty will be smaller, or the couple may even save tax by marriage. Roughly speaking, the marriage penalty

Table 2

Married Penalties in 1979

If two single people, each with: taxable incomes of...	...marry, and have a combined taxable income of...	... their combined tax increases from...	..to..	...for a marriage penalty of...
$ 5,000	$10,000	$ 844	$ 1,062	$ 218
10,000	20,000	2,774	3,225	451
15,000	30,000	5,210	6,238	1,028
20,000	40,000	8,354	10,226	1,872
30,000	60,000	15,924	19,678	3,754

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April 2, 1980

"Taxable income" is total income minus exemptions of $1,000 per person. Calculations assume that the taxpayers do not itemize their deductions. Assumes no children.

affects couples where the spouse with the lower earnings contributes at least 20 percent of the combined income.

Married persons may file separately if they wish, but they must use the highest of the four rate shedules, and other special provisions occur throughout the Code to prevent them from saving tax in this way. As a consequence, the option for a married couple to file separate returns is not a defense against the marriage penalty.

b. Single Penalty. A single taxpayer often pays more tax than a married couple with the same income. For example, a single person with a taxable income of $15,000 pays $2,605 tax. But if a married couple has the same taxable income, even if it is all earned by one spouse, their tax is $2,055. In this case, the single person pays 27 percent more tax. (See Table 3 for examples of single penalties at selected levels of taxable income.)

These examples of the marriage and single penalties only take account of the differing rate schedules and zero bracket amounts. There are a large number of other provisions that impact on the tax treatment of married and single people. In some cases, single individuals and married couples filing jointly are subject to the same dollar limitations. Examples are the $3,000 capital loss limitation and the maximum expenditures qualifying for the residential energy credit. In other cases, such as the interest and dividend exclusion, the limitation for married couples filing jointly is twice that of single individuals. There are also cases where the limitation for married couples filing jointly are higher than that for single individuals but not twice as high. Examples include the maximum base and the beginning of the income phase out for the credit for the elderly. Also, in order to claim the earned income credit, the credit for the elderly, and the disability income exclusion, married couples generally are required to file jointly. These credits are phased out based on combined income.

Economic Considerations

The current tax treatment of the second earners (or secondary investors) among married couples tends to distort decisions about labor market entry choices, about choices among occupations, about investment in education and training, and about investment in risk capital. This follows from the fact that second earners under the present system of combined income on joint returns face higher marginal tax rates than the rates faced by their spouses who are the primary earners or the rates faced by single persons. The argument can be made that the marginal tax rates of secondary earners -- typically women -- should be lower not higher than that of single women and married men.

Table 3

Single Penalties in 1979

If married couple with one earner and with taxable income of...	...divorces and the earner continues to have taxable income of...	...the earner's tax increases from...	....to....	...for a single penalty of...
$ 5,000	$ 5,000	$ 224	$ 422	$ 198
10,000	10,000	1,062	1,387	325
15,000	15,000	2,055	2,605	550
20,000	20,000	3,225	4,177	952
30,000	30,000	6,238	7,962	1,724

Office of the Secretary of the Treasury
Office of Tax Analysis

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"Taxable income" is total income minus exemptions of $1000 per person. These calculations assume that the taxpayers do not itemize their deductions.

that married women have substantial discretion over their labor market activity, that is, they have a substantially higher elasticity of supply of labor than do single persons or married men. Thus, economic efficiency would be served if the marginal tax rates of secondary earners were lower than present rates. Economic efficiency in this sense means a reduction in the economic loss to society created by this distortion in labor force activity of married women.

Dimensions of the Problem

The marriage penalty and single penalty have become more serious issues as a result of increasing rates of divorce and cohabitation of unmarried couples, and the two-earner married couple problem also has become a more serious issue as a result of increasing labor force participation by wives.

The most recent tax return data indicate that a marriage penalty is realized by a substantial number of couples filing joint tax returns. For tax year 1979, approximately 16 million will be affected by a marriage penalty totalling $8.3 billion, while 24 million will experience a marriage bonus of $19 billion.1/ (See Table 4.)

Labor force participation rates of wives of married couples since 1940 demonstrate the substantial growth of two-earner families. (See Table 5.) The participation rate by wives increased more than 300 percent since 1940. The one-earner couple is no longer the predominant case. According to Census data, in 1940 the one-earner couple accounted for almost two-thirds of all households. In 1978, the one-earner couple accounted for only about one-third.

Basic Options

The compromise between reducing the marriage penalty and the single penalty is always an uneasy one. The marriage penalty, in particular, has become one of the most widely criticized aspects of our income tax. But as long as the first two goals -- progressivity and taxing combined income -- are adhered to, the marriage penalty cannot be reduced without making the situation for single taxpayers even worse.

1/ In making these estimates, it is assumed that exemptions and deductible expenses are allocated in proportion to each spouse's income. However, one spouse may itemize while the other spouse may use the "zero bracket amount" but the latter's deductible expenses are not assumed to be shifted to the itemizing spouse. Had it been assumed that each couple engages in tax minimization by allocating deductions, the number with a marriage penalty will be an estimated 18 million and the penalty will amount to an estimated $13 billion at 1979 income levels.

Table 4

Distribution of Marriage Penalty and Marriage Bonus
by Income Class under Present Law 1/

(1979 Law, 1979 Income Levels)

:panded ncome lass	Marriage Penalty			Marriage Bonus		
	Number of returns	Amount	Average marriage penalty	Number of returns	Amount	Average marriage penalty
(000)	(thousands)	($ millions)	(dollars)	(thousands)	($ millions)	(dollars)
than 10	655	$ 83	$ 124	4,120	$ 1,063	$ 258
- 15	2,058	437	212	3,940	1,439	365
- 20	3,207	905	283	3,650	1,809	496
- 30	6,416	2,350	366	6,196	4,632	748
- 50	2,867	2,46[illegible]	860	4,412	5,755	1,304
) - 100	527	1,179	2,235	1,297	3,303	2,548
) - 200	123	494	4,018	185	764	4,127
and over	54	424	7,909	26	395	15,207
Total	15,906	$8,340	$ 524	23,827	$19,160	$ 804

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Details may not produce totals due to rounding.

pendent exemptions and deductible expenses are allocated to each spouse
proportion to each spouse's income and not in accordance with tax
nimizing behavior.

Table 5

Labor Force Participation Rates of Wives
of Married Couples
1940 - 1978

Date	Participation Rates (Percent)
1940	14.7%
1950	23.8
1960	30.5
1970	40.8
1971	40.8
1972	41.5
1973	42.2
1974	43.0
1975	44.4
1976	45.0
1977	46.6
1978	47.6

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Source: U.S. Bureau of Labor Statistics.

The Administration does not favor reducing the current level of progressivity. Therefore, any approach which alleviates both the marriage penalty and the single penalty must violate the combined income goal, that is, there must be some tax differential in the tax law between one-earner and two-earner married couples.

Critics of the combined income goal argue that an economic difference justifies such a distinction: one-earner couples have the benefit of a full-time homemaker. Although the homemaker's services in the home are not measured in dollars, they do increase a couple's economic well-being and ability-to-pay. Two-earner couples do not have that advantage, and, arguably, this should result in a lower tax liability. According to a recent OECD survey, every industrialized nation with an income tax, except the United States, distinguishes between one-earner and two-earner couples, and even in the United States, the child care credit may be viewed as a distinction between one-earner couples without children and two-earner couples with children. It is one thing, of course, to support such a distinction and quite another to agree on what form it should take.

1. Abandon Joint Returns; Require Separate Returns by Married Persons

One option is to abandon joint returns and income splitting and to require separate returns by married persons. This approach would also abandon head of household and surviving spouse statuses and abandon differential rate schedules for single persons and separate returns of married couples. Incidentally, most experts agree that Congress can require that each married person pay tax on his or her own income, determined without regard to State community property laws.

This option would eliminate both the marriage penalty and the single penalty. Only the combined income goal would be violated, as was the case in the pre-1948 income tax. The administrative convenience of joint returns could be retained by allowing married couples to file their "separate" returns on two parts of the same standard form, as is now done in some State income tax systems.

The drawback of this option is that taxpayer compliance and tax administration would be complicated if married couples are required to file separately. There is the substantial technical problem of the assignment of income and deductions among spouses.

How should property income be assigned for tax purposes? Should it be based on ownership? If it were, it would create a real incentive to reduce tax by shifting ownership to the

spouse with the least income. Special rules would be needed for trusts where one spouse receives the income from a property and the other spouse retains a reversionary interest in the property. Should ownership be assigned to the spouse with the most income? If it were, it would be considered unfair because property income would be taxed at higher marginal tax rates. There are, of course, many other possibilities for assignment of property income. One possibility is to split property income on a 50/50 basis, even though it would treat property income more favorably than earned income.

How should earnings be assigned among spouses for tax purposes? It appears best to assign such income on the basis of actual earnings of the spouses, even though families engaged in closely-held businesses and farms, could allocate earnings to a lower earning spouse rather arbitrarily.

A similar problem would exist with respect to allocation of exemptions and deductions. One possibility would be to prorate the total amount of exemptions and deductions in accordance with the distribution of total income between the spouses.1/

Another drawback of the mandatory option is its impact on tax burdens. Although the marriage and single penalties now created by differential rate schedules would be eliminated, tax burdens of individual taxpayers in terms of tax increases or tax decreases would depend on the rate schedule chosen. For example, if mandatory separate returns were required to use the current single person's rate schedule (and if heads of households and surviving spouses were also required to do so), almost all one-earner couples now receiving marriage bonuses, heads of households, and surviving spouses would have tax increases and some two-earner couples would have tax increases also. On the other hand, many two-earner families would have tax reductions. The tax increases in this approach would probably be unacceptable and other alternatives need to be considered.

To minimize the number of taxpayers who would have a tax increase, all taxpayers could be allowed the use of the most beneficial tax rate schedule in the law -- that is the one

1/ It should be noted that the revenue estimates for this option and others which follow assume, where necessary, the 50/50 assignment rule for property income, the actual earnings rule for earned income, and the prorated allocation of exemptions and deductions according to total income.

for joint returns. The revenue cost of mandatory separate returns using the current joint return rate schedule would be $29.5 billion. (See Table 6.) But the high revenue cost of mandatory separate returns would be a serious drawback.

2. Optional Separate Returns

A less costly alternative to mandatory separate returns would be to provide couples an option of filing jointly, as under present law, or filing separate returns as single persons. Heads of households and surviving spouses would continue to use their present rate schedules.

This option is a simple and straightforward way to eliminate the marriage penalty. Its drawback is that it would not eliminate or reduce the marriage bonus (or single penalty). Under this approach, those benefitting from the marriage bonus (one-earner couples and two-earner couples with a low earner) would not be made worse off, except in a relative sense. They would generally continue to file joint returns to take advantage of the marriage bonus.

Optional separate returns has the same drawback of mandatory separate returns, namely in the assignment of income and allocation of deductions. In addition, optional separate returns could seriously complicate taxpayer compliance since many couples would have to compute taxes two ways to determine which way minimizes taxes.

The revenue cost of optional separate returns treated as single persons would be $8.3 billion. (See Table 6.)

The Fenwick bill, H.R. 3609, essentially follows this approach. However, the bill allocates property income on the basis of ownership and therefore would provide a tax minimization incentive for the high earning spouse to transfer property to the low earning spouse. The implication of this feature should be carefully considered in view of the bill's intent to remove a tax bias against marriage. Is it appropriate to introduce a tax bias to influence a couple's decision on who should have title to property?

The bill would also introduce a serious tax bias with respect to itemized deductions. It would not allocate deductions according to income but would allocate each itemized deduction to the spouse who actually makes the payment. Thus, married couples would have to decide continuously during the tax year which one should write the check for say, the monthly mortgage payment, the charitable contribution, the doctor's payment, and so forth. This would carry tax planning too far. Allocation of itemized deductions according to income would appear to be simpler and

Table 6

Revenue Effects of Alternatives Reducing Marriage Penalty and Reduction in Marriage Penalty 1/

(1979 Law, 1979 Levels)

($ billions)

Item	Mandatory Separate returns; joint return rates for all taxpayers	Optional Separate returns; single person rates	Two-earner couples: Deduction 10 percent of first $20,000 earnings of lowest earning spouse	Cona H.
Current law marriage penalty	8.3	8.3	8.3	
Cost of alternative:				
Married couples:				
Reduction in marriage penalty	8.3	8.3	2.8	
Increase in marriage bonus	9.7	--	0.7	
Heads-of households	1.2	--	--	
Single individuals	10.2	--	--	
Total cost of alternative ...	29.5	8.3	3.5	
Remaining marriage penalty	0.0	0.0	5.6	
Percentage reduction in marriage penalty	100.0%	100.0%	34.0%	3

Office of the Secretary of the Treasury
Office of Tax Analysis

April 2,

Note: Details may not add to totals due to rounding.

1/ Dependent exemptions and deductible expenses are allocated to each spouse in propo[rtion] to each spouse's income and not in accordance with tax minimizing behavior.

3. Special Deduction or Exclusion on Joint Returns

If joint returns in their present form are preferred, it would still be possible to distinguish between one-earner and two earner couples, by allowing a special deduction (or credit) based on the earnings of the second earner. It would be a simpler option in terms of compliance and administration than optional separate returns. A deduction from adjusted gross income of some portion of the lower earning spouse's income would be allowed. Depending on the deduction levels, this scheme would partially alleviate the marriage penalty. It would only give relief among two-earner couples. It would not alleviate any marriage penalty among two-earner couples resulting from investment income.

The drawback of this option is that some couples would receive tax relief in excess of their marriage penalty under present law. Therefore, an evaluation of this approach should include examination of how the total revenue loss should be allocated between reduction of the marriage penalty and increase of marriage bonus or single penalty.

Under this option, consider for illustrative purposes a deduction equal to 10 percent of the first $20,000 of the lower earner's income. The revenue cost would be $3.5 billion. (See Table 6.) About 79 percent of the total cost would be allocated to reducing the marriage penalty and about 21 percent would be allocated to increasing the marriage bonus. The 10 percent deduction would eliminate about 34 percent of the marriage penalty under present law. It is noteworthy that the bulk of the lower earning spouses' incomes falls well below the assumed $20,000 ceiling. Consequently, a higher ceiling above $20,000 would have no significant effect either on the option's cost or on reduction of the marriage penalty.

The number of returns experiencing a marriage penalty and the penalty amount would decline at each income level under this approach. (See Table 7.) Since the cost would also include tax relief in excess of the marriage penalty, it may be more equitable and less costly to target the tax relief more specifically at two-earner couples with a marriage penalty.

The Conable bill, H.R. 6822, does just that. It is essentially the same 10 percent deduction option. But it would be available only to two-earner couples if the earnings of the lower earning spouse is at least 20 percent of the total earnings of the couple.

The revenue cost of the Conable bill would be $3.1 billion. (See Tables 6 and 8.) About 87 percent of the cost would be allocated to reducing the marriage penalty and about 32 percent of the marriage penalty would be eliminated.

Table 7

Distribution of Marriage Penalty Under Present Law and Under Two-Earner Option to Deduct 10 Percent of the First $20,000 Earned by Lowest Earning Spouse by Income Class 1/

(1979 Law, 1979 Income Levels)

Expanded income class	Marriage penalty under present law			Marriage penalty remaining u[nder] the option		
	Number of returns	Amount	Average marriage penalty	Number of returns	Amount	Ave[rage] mar[riage] pen[alty]
($000)	(thousands)	($ millions)	(dollars)	(thousands)	($ millions)	(dol[lars])
Less than 10	655	$ 83	$ 124	$ 561	$ 65	
10 - 15	2,058	437	212	1,831	312	
15 - 20	3,207	908	283	2,584	589	
20 - 30	6,416	2,350	366	4,025	1,233	
30 - 50	2,867	2,465	860	2,034	1,489	
50 - 100	527	1,179	2,235	485	996	
100 - 200	123	494	4,018	120	461	
200 and over	54	424	7,909	53	415	
Total	15,906	$8,340	$ 524	11,692	$5,560	

Office of the Secretary of the Treasury
Office of Tax Analysis

April

Note: Details may not produce totals due to rounding.

1/ Dependent exemptions and deductible expenses are allocated to each spouse in proportion to each spouse's income and not in accordance with tax minimizing behavior.

Table 8

Distribution of Marriage Penalty Under Present Law and Under Conable Bill, (H.R. 6822) to Deduct 10 Percent of the First $20,000 Earned by Lowest Earning Spouse if the Spouse's Earnings are 20 Percent or More of Total Income of Two-Earner Couples 1/

(1979 Law, 1979 Income Levels)

...nded ...come ...ss ...	Marriage penalty under present law: Number of returns	Amount	Average marriage penalty	Marriage penalty remaining under Conable bill (H.R. 6822): Number of returns	Amount	Average marriage penalty
...000)	(thousands)	($ millions)	(dollars)	(thousands)	($ millions)	(dollars)
...than 10	655	$ 83	$ 124	$ 561	$ 65	$116
... 15	2,058	437	212	1,858	313	168
... 20	3,207	908	283	2,690	601	223
... 30	6,416	2,350	366	4,292	1,256	293
... 50	2,867	2,465	860	2,133	1,509	707
... 100	527	1,179	2,235	511	1,016	1,989
... 200	123	494	4,018	123	473	3,854
...d over	54	424	7,909	54	420	7,829
...al	15,906	$8,340	$ 524	12,222	$5,654	$463

...f the Secretary of the Treasury
... of Tax Analysis

April 2, 198...

...tails may not produce totals due to rounding.

...dent exemptions and deductible expenses are allocated to each spouse ...oportion to each spouse's income and not in accordance with tax ...izing behavior.

Conclusion

The Administration believes that high priority should be given to reducing both the marriage and single penalties when the individual income tax reductions next are made. The Administration, however, is not prepared at this time to recommend one of the three basic approaches -- mandatory separate returns, optional separate returns, or a special deduction or credit. A strong case can be made for each approach. The first two involve more basic structural changes than the third. Yet they may be appropriate if there is a general consensus that the family should no longer be the basic unit of taxation. The third option involves less complexity but may be considered only partially corrective. The choice among the approaches may very well depend on which one receives general acceptance, and these hearings provide a good opportunity to gauge the views of interested groups.

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GTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE April 2, 1980

RESULTS OF AUCTION OF 15-YEAR 1-MONTH TREASURY BONDS

The Department of the Treasury has accepted $1,501 million of $3,875 million of tenders received from the public for the 15-year 1-month bonds auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	12.60%
Highest yield	12.72%
Average yield	12.69%

The interest rate on the bonds will be 12-5/8%. At the 12-5/8% rate, the above yields result in the following prices:

Low-yield price	100.092
High-yield price	99.293
Average-yield price	99.492

The $1,501 million of accepted tenders includes $216 million of noncompetitive tenders and $1,285 million of competitive tenders from private investors, including 79% of the amount of bonds bid for at the high yield.

M-412

12-5/8% TREASURY BONDS OF 1995
~~TREASURY NOTES OF SERIES~~

DATE: April 2, 1980

HIGHEST SINCE:

LAST ISSUE:
10-1/2% (AVG. 10.60%)

LOWEST SINCE:

TODAY:
12-5/8% (AVG. 12.69%)

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FOR IMMEDIATE RELEASE
April 2, 1980

Contact: Robert E. Nipp
202/566-5328

MEMORANDUM TO CORRESPONDENTS

Attached for your information is the Joint Communique on the Fifth Session of the U.S.-Saudi Arabian Joint Commission on Economic Cooperation. The Joint Commission was co-chaired by Secretary of the Treasury G. William Miller and Saudi Arabian Minister of Finance and National Economy Muhammad Ali Abalkhail in Washington, D.C. on April 1-2, 1980.

M-413

JOINT COMMUNIQUE
ON THE FIFTH SESSION OF THE U.S.-SAUDI ARABIAN
JOINT COMMISSION ON ECONOMIC COOPERATION
WASHINGTON, D.C. APRIL 1-2, 1980

The United States-Saudi Arabian Joint Commission on Economic Cooperation met for its Fifth Formal Session in Washington, D.C., April 1-2, 1980. The Secretary of the Treasury of the United States, the Honorable G. William Miller, chaired the meeting. The Minister of Finance and National Economy of the Kingdom of Saudi Arabia, His Excellency Muhammad Al-Ali Abalkhail, Co-Chairman of the Joint Commission, led the Saudi Arabian delegation. Mr. Faisal Alhegelan, the Saudi Arabian Ambassador to the United States, and Mr. John C. West, the U.S. Ambassador to the Kingdom of Saudi Arabia, also participated in the meeting.

Also attending as delegates for Saudi Arabia were: Dr. Mansoor Al Turki, President of Riyadh University and Joint Commission Coordinator; Rida Obaid, Chairman and Director of the Saudi Arabian National Center for Science and Technology; Mohammad Al-Fayez, Deputy Minister, Ministry of Labor and Social Affairs; Yousef Al-Hamdan, Deputy Minister, Ministry of Commerce; Nasser Al-Salloum, Deputy Minister, Ministry of Communications; Abdul Aziz Mangoor, Director General, Saudi Arabian Agricultural Bank; Fouad Al-Farsy, Deputy Minister, Ministry of Industry and Electricity; Khalid Masaud, Deputy Director, Saudi Fund for Development and Deputy Coordinator of the Joint Commission; Mohammad Dhalaan, Assistant Deputy Minister, Ministry of Labor and Social Affairs; Ahmed M. Moumina, Minister Plenipotentiary, Ministry of Foreign Affairs; Ibrahim Darrab, Director General for Planning, Organization and Budget, Ministry of Agriculture and Water; Yousef Saleh Malaika, Director of Sectoral Coordination, Ministry of Planning; Mohammed Al-Darees, Director of the Office of International Economic Relations, Ministry of Finance and National Economy; Youssef H. Al-Hazmi, Senior Engineer, Saline Water Conversion Corporation.

The American delegation included Richard Cooper, Under Secretary of State for Economic Affairs, C. Fred Bergsten, Assistant Secretary of the Treasury for International Affairs and U.S. Coordinator of the Joint Commission; Leamon R. Hunt,

Treasury Deputy for Saudi Arabian Affairs; Wallace M. Riley, Director of the U.S. Representation to the Joint Commission in Riyadh; and Bonnie Pounds, Director of the Office of Saudi Arabian Affairs in Treasury.

Other members of the American delegation were: Laird D. Allshouse, Director, Office of Foreign Operations Staff, U.S. Customs Service; Quentin West, Special Assistant for International Scientific Technical Cooperation, Department of Agriculture; Gary Cobb, Director, Office of Water Research and Technology, Department of Interior; Dean K. Clowes, Deputy Under Secretary for International Affairs, Department of Labor; Herta Lande Seidman, Assistant Secretary for Trade Development, Department of Commerce; Meyer Zitter, Assistant Director for International Programs, Bureau of the Census; William Johnston, Assistant Secretary for Policy and International Affairs, Department of Transportation; John S. Hassell, Jr., Acting Administrator, Federal Highway Administration; Holsey G. Handyside, Deputy Assistant Secretary for International Affairs, Department of Energy; John H. Bryant, Deputy Assistant Secretary for International Health, Department of Health, Education and Welfare; Lawton Saunders, Acting Director, International Projects, General Services Administration; Harvey Averch, Assistant Director, Scientific, Technological and International Affairs Directorate, National Science Foundation; and, Larry Edwards, Acting Deputy Governor, Farm Credit Administration.

Meetings were also held outside the framework of the Joint Commission with Treasury, State Department, and White House officials, and calls were paid by the Saudi Finance Minister on Secretary of State Cyrus R. Vance, and Chairman of the Federal Reserve Board Paul Volcker. These meetings provided an opportunity to review the U.S. world economic situation, exchange market developments, and world payments patterns. These sessions also served to reinforce the feelings of friendship and cooperation which have long existed between the two countries.

The two delegations noted with satisfaction the extension of the Technical Cooperation Agreement which provides the framework for the operations of the Joint Commission. The extension was signed on November 25, 1979, by the Co-Chairmen during Secretary Miller's visit to Saudi Arabia, and will be the basis for continued Commission activity until February 13, 1985.

Pursuant to the terms of the Extension Agreement, the Commission reviewed the status and progress of cooperative projects carried out under the auspices of the Commission and discussed new areas of cooperation between the two countries. The discussions made clear the high priority both governments place on bilateral technical cooperation under the Joint Commission and the significant contribution the program makes to strengthening the ties between the two countries.

The Chairman and members of the Saudi delegation took the opportunity of their stay in Washington to hold meetings outside the Joint Commission framework with senior officials of the Department of State, Department of Treasury, and other U.S. agencies. These discussions enabled both sides to review the broad range of U.S.-Saudi relations, as well as to exchange views on the global financial and economic situation.

In addition to the plenary sessions, special bilateral working groups met to review in detail the cooperative projects in the various fields of Joint Commission activity, with particular emphasis on recently expanded and new projects in agriculture and water, desalination, agricultural credit, manpower training and development, science and technology research, highway administration, and consumer protection.

The working group on agriculture and water development met with senior officials of the Department of Agriculture and the Department of the Interior to review both the project agreement for the provision of specialists to the Saudi Ministry of Agriculture and Water and the project for development of the Asir National Park to be opened in November 1980. It was agreed that the U.S. specialists are making important contributions to a wide variety of Ministry programs and that planning would continue to permit their expanded participation in additional Ministry activities.

In the field of water development, a separate working group on desalination research and training met with senior Department of the Interior officials and with the Director and staff of the Office of Water Research and Technology. The two areas of project activity under the U.S.-Saudi Arabian desalination agreement were reviewed in detail and possibilities for expanding U.S. participation were explored.

A working group on agricultural bank management and training met with Farm Credit Administration officials to review the provisions of the bilateral agreement and to discuss the next phases of management support, as well as university and on-the-job training programs.

Discussions of the working group on manpower training and development centered on the adequacy of technical support for this project, including the urgency of recruiting to fill authorized positions, budget requirements, progress, and future projections. Careful review was given to plans underway for training Saudi vocational training staff in U.S. institutions. Significant problems were recognized and action plans agreed upon to achieve accelerated progress during the coming year.

In science and technology, a working group met to review present and future cooperation between the National Science Foundation (NSF) and the Saudi Arabian National Center for Science and Technology (SANCST). Discussions focused on the continued development of the SANCST Science and Technology Information System, assistance by NSF in the preparation of the SANCST Master Plan for development of institutional facilities, planning for the SANCST Science and Technology Information Center, and continued assistance for the SANCST Applied Research Grants Program.

Also in the scientific field, the Joint Commission took note of the activities of the U.S.-Saudi Arabian cooperation program in the field of solar energy. The major cooperative solar energy activities include the design and construction of a 350 kilowatt photovoltaic solar cell system for producing electricity for two remote villages outside of Riyadh The solar powered system is expected to be operating by June, 1981.

The U.S.-Saudi Arabian solar energy program has also signed contracts with four U.S. companies to undertake field tests in the U.S. of five solar cooling systems designed for use in commercial buildings. A contract is expected to be signed in mid-1980 for the design, construction and operation of a solar powered desalination system to desalt brackish water and convert seawater to fresh water for human consumption and agricultural and industrial use. Efforts are also underway to support solar cooling research laboratories at four Saudi Arabian universities. Two short study course/tours for U.S. and Saudi Arabian graduate students were held in 1979, and a solar cooling workshop is scheduled for April 1980 at the University of Petroleum and Minerals in Dhahran, Saudi Arabia.

In the field of highway administration and training, discussions were held reviewing the basic work that has been accomplished between the Federal Highway Administration and the Saudi Ministry of Communications towards the improvement of the Ministry's overall capabilities in the area of highwa

transportation. Ways and means to improve present effectiveness and long range planning were reviewed. Particular emphasis was placed on development of manageral and technical procedures which will lead to more effective operations of the Ministry.

Discussions were held with the Office of the Secretary of Transportation regarding mutual interest in the development of transportation in the Kingdom of Saudi Arabia, including national intermodal transport. The Office of the Secretary of Transportation will submit a specific proposal to the Minister of Communications regarding the implementation of the plans discussed.

The Joint Commission's consumer protection project was discussed in a group including management representatives of Midwest Research Institute, the U.S. firm carrying out this project under a contract with Treasury.

OVERALL ASSESSMENT

The Fifth Session of the Commission proved to be most valuable since it combined useful plenary sessions with a series of technical meetings of bilateral working groups. This new approach was welcomed by the two delegations since it permitted more detailed reviews of the Joint Commission programs, and fostered closer working relationships between the Saudi and U.S. Government officials.

The Commission expressed its thanks to all the participating Saudi Arabian ministries and American departments and agencies for their fine spirit of cooperation. It was agreed that both sides will continue to explore possible new areas of technical cooperation.

In concluding its 1980 session, the Joint Commission approved the issuance of an Annual Report which outlines the purpose of the Commission and its development during the past five years, and provides detailed information regarding the various projects.

The report will be issued shortly in printed form in English and Arabic. An advance copy of the English text as approved by the Commission is available.

The Co-Chairmen agreed to hold the next Joint Commission meeting in the Kingdom of Saudi Arabia in 1981.

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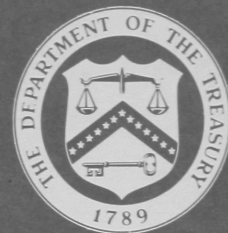

OFFICE OF PUBLIC AFFAIRS Contact: Carolyn Johnston
(202) 634-5377

FOR IMMEDIATE RELEASE April 9, 1980

TREASURY SECRETARY MILLER APPOINTS FRED A. STICKEL AS NEW SAVINGS BONDS CHAIRMAN FOR OREGON

Secretary of the Treasury G. William Miller has appointed Fred A. Stickel, President and Publisher, Oregonian Publishing Company, as Volunteer State Chairman for the Savings Bonds Program in Oregon. The appointment is effective immediately.

He succeeds Thomas S. Prideaux, Vice Chairman of the Board, U.S. Bancorp.

Mr. Stickel will head a committee of business, financial, labor, media and governmental leaders, who -- in cooperation with the Savings Bonds Division -- assist in promoting the sale of savings bonds.

Mr. Stickel joined the Oregonian Publishing Company as General Manager, serving in that capacity from 1967-1972. In 1972 he became President and assumed the additional duties of Publisher in 1975.

Mr. Stickel's directorships include the United Way of Oregon and the National Conference of Christians and Jews. He is also Vice President, Portland Newspaper Association, and a member of the Board

(over)

of Regents, University of Portland.

Prior to joining the Oregonian Publishing Company, Mr. Stickel lived and worked in Hoboken, N.J., where he was the Advertising Director and later the Publisher of the Jersey Journal. Active in community affairs, he was Vice President of the Jersey City Chamber of Commerce, President of the Jersey City United Community Fund and Director of the Jersey City YMCA. He and his wife Margaret have six children.

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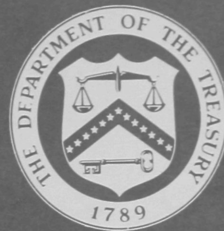

April 4, 1980

CURTIS A. HESSLER

Curtis A. Hessler, 36, was nominated by President Carter on March 5, 1980 to be Assistant Secretary of the Treasury for Economic Policy, confirmed by the Senate on March 27, 1980 and sworn in by Secretary Miller on April 4, 1980. Since July, 1979, Mr. Hessler was an Associate Director of the Office of Management and Budget. Prior to that Mr. Hessler was Executive Assistant to the Secretary of the Treasury. He also served as Executive Director of the Economic Policy Group and Executive Secretary of the Treasury Department.

Hessler took a BA degree from Harvard College (1966), an MA degree in economics from the University of California, Berkeley (1976), and a J.D. degree from the Yale Law School (1973). He studied economics as a Rhodes Scholar at Baliol College, Oxford, 1966-1969, and is completing a doctorate in international economics at University of California, Berkeley.

In 1974-5, Hessler served as law clerk to Supreme Court Justice Potter Stewart, after a year in similar capacity with Judge J. Skelly Wright in the U.S. Court of Appeals, Washington, D.C.

Hessler practiced law in Los Angeles with the firm of Munger, Tolles and Rickershauser before joining the Carter-Mondale Transition Team in 1976. He worked previously as a correspondent for Newsweek Magazine in Africa and Time Magazine in London and Los Angeles.

Hessler lives in Washington, D.C. with his wife, Christine and son, Alexander.

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IMMEDIATE RELEASE
Friday, April 4, 1980

Contact: Everard Munsey
566-8191

TASK FORCE ON THRIFT INSTITUTIONS ESTABLISHED

The Treasury Department today announced formation of an interagency task force to study and make recommendations on several matters related to thrift institutions.

The task force will be co-chaired by Deputy Secretary of the Treasury Robert Carswell and Stuart Eizenstat, Assistant to the President for Domestic Affairs and Policy. Also represented on the task force are the Office of Management and Budget, the Council of Economic Advisers, the Department of Housing and Urban Development, the Federal Reserve Board, the Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the National Credit Union Administration Board.

The task force is required by the Depository Deregulation and Monetary Control Act to study and make recommendations to Congress by June 30, 1980 on the options available to increase the ability of thrift institutions to pay market rates of interest in periods of rapid inflation and high interest rates.

The task force must also consider what might be done "through the Federal Home Loan Bank System and other agencies to assist thrifts in times of economic difficulties."

The Act, which was signed by President Carter on March 31, provides for major financial reforms, including a gradual increase in the rate of interest small savers can earn on their deposits. Under the Act, limits on interest payments to small savers must be eliminated over six years. The Act also gives thrift institutions expanded powers, including authority for savings and loans to make consumer and educational loans, issue credit cards and provide trust services and for mutual savings banks to make commercial loans.

The Act provides for extensive public participation in the task force's study.

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CONTACT: ROBERT W. CHILDERS
(202) 634-5248

FOR IMMEDIATE RELEASE April 7, 1980

REVENUE SHARING FUNDS DISTRIBUTED

The Department of Treasury's Office of Revenue Sharing (ORS) distributed approximately $1.7 billion in general revenue sharing payments today to over 36,000 State and local governments.

Current legislation authorizes the Office of Revenue Sharing to provide quarterly revenue sharing payments to State and local governments through the end of Federal fiscal year 1980.

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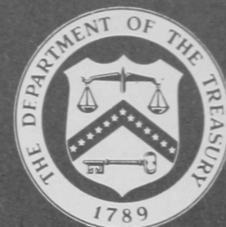

FOR IMMEDIATE RELEASE April 7, 1980

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,401 million of 13-week bills and for $3,400 million of 26-week bills, both to be issued on April 10, 1980, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 10, 1980			:	26-week bills maturing October 9, 1980		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	96.416 a/	14.178%	14.91%	:	92.902	14.040%	15.32%
Low	96.334	14.503%	15.26%	:	92.745	14.351%	15.69%
Average	96.354	14.424%	15.18%	:	92.808	14.226%	15.54%

a/ Excepting 1 tender of $580,000

Tenders at the low price for the 13-week bills were allotted 42%.
Tenders at the low price for the 26-week bills were allotted 57%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 73,220	$ 63,220	:	$ 46,180	$ 46,180
New York	4,260,970	2,430,770	:	4,164,655	2,566,605
Philadelphia	37,520	37,520	:	21,155	21,155
Cleveland	98,835	58,835	:	40,120	40,105
Richmond	60,185	60,170	:	56,695	56,675
Atlanta	82,425	82,425	:	62,595	62,595
Chicago	365,785	151,085	:	388,855	142,845
St. Louis	48,925	43,765	:	60,140	54,140
Minneapolis	26,195	26,195	:	21,370	21,370
Kansas City	68,985	68,985	:	42,865	42,865
Dallas	37,115	37,115	:	22,995	22,995
San Francisco	372,410	201,010	:	316,995	214,095
Treasury	139,895	139,895	:	108,655	108,655
TOTALS	$5,672,465	$3,400,990	:	$5,353,275	$3,400,280
Type					
Competitive	$3,628,925	$1,357,450	:	$3,813,925	$1,860,930
Noncompetitive	1,115,140	1,115,140	:	751,350	751,350
Subtotal, Public	$4,744,065	$2,472,590	:	$4,565,275	$2,612,280
Federal Reserve	776,810	776,810		775,000	775,000
Foreign Official Institutions	151,590	151,590	:	13,000	13,000
TOTALS	$5,672,465	$3,400,990	:	$5,353,275	$3,400,280

1/Equivalent coupon-issue yield.

M-418

DATE: April 7, 1980

	13-WEEK	26-WEEK
TODAY:	14.424%	14.226%
LAST WEEK:	15.037%	14.804%
HIGHEST SINCE:		
LOWEST SINCE:		
2/25/80	13.700%	13.629%

Department of the TREASURY

NEWS

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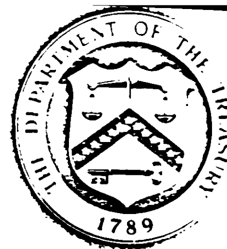


FOR IMMEDIATE RELEASE
April 7, 1980

CONTACT: Everard Munsey
202/566-8191

TREASURY DIRECTS CENSUS OF BLOCKED IRANIAN ASSETS AND OF CLAIMS BY U.S. PERSONS AGAINST IRAN; ADOPTS SANCTIONS REGULATIONS

The Treaury Department today issued regulations to inventory claims by U.S. persons against Iran and blocked Iranian assets and to implement the economic sanctions on Iran imposed today by President Carter.

The inventory will aid in developing a program to settle claims against Iran by the American hostages and their families and other U.S. claimants.

Information submitted in the claims survey would not constitute formal claims against Iran. However, the President announced today that legislation would be prepared for a formal claims program.

The claims against Iran, to be reported by all claimants by May 15, 1980, are those arising from expropriation, nationalization, exchange controls or other takings of property in Iran, such as defaults on loans to Iran, damages for breach of contract and personal claims for salaries or for injury to persons or property by Iran.

Reports, to be submitted on Treasury form TFR 616, must cover claims arising before April 15, 1980. Failure to submit a report of claims would be a violation of the Iranian Asset Control Regulations and could prejudice the status of any claim under a formal claims program.

Upwards of $8 billion in Iranian official assets were blocked or frozen by President Carter. The survey of assets, with reports also due by May 15, will provide additional detail on the amount and location of assets held by individuals and companies in the United States and foreign branches and subsidiaries of U.S. companies in which Iran, the Iranian national bank or other Iranian government-controlled entities have an interest.

The report on assets must cover the period between November 15, 1979 and March 31, 1980 and be submitted on form TFR 615.

The amendments to the Iranian Asset Control Regulations to implement the economic sanctions against Iran prohibit all exports to Iran other than food, medicine or medical supplies and donated clothing -- which is excluded from the sanctions by statute.

The November 14, 1979 freeze of Iranian official assets, as announced by Secretary of the Treasury G. William Miller, was not aimed at blocking commercial transactions or imposing a trade embargo. While the freeze nevertheless had the effect of substantially limiting exports to Iran, today's action will make the restraints on exports explicit and more effective, cover all entities and persons in Iran -- not just government entities -- and prohibit new service contracts.

The regulations also forbid:

* shipments of the prohibited exports to Iran in U.S. or Iranian vessels;

* new industrial service contracts in Iran except those concerned with medical care;

* new credits or loans, new deposit facilities or increases in non-dollar deposits greater than 10 percent above the average daily balance during the last six months;

* unusually favorable payment terms, defined as sales on conditions "sharply different" from those offered by other sellers of the same commodity in terms of price or time of payment, and

* any transaction which has the purpose or effect of evading or avoiding the prohibitions in the Regulations.

The Asset Control Regulations, as amended today and previously, implement United Nations Security Council Resolution 461, adopted December 31, 1979, calling for economic sanctions on Iran if the American hostages were not freed by January 7, 1980. A resolution mandating economic sanctions on Iran would have been adopted by the Security Council on January 13, 1980 but for a veto by the Soviet Union.

Violators of the Iranian Asset Control Regulations are subject to civil penalties of up to $10,000. Willful violations may be punished by fines of up to $50,000 and/or imprisonment of up to 10 years.

The new Regulations, to be published in the Federal Register, are available from the Treasury.

# # #

FOR IMMEDIATE RELEASE APRIL 7, 1980

Office of the White House Press Secretary

THE WHITE HOUSE

EXECUTIVE ORDER

- - - - - - -

PROHIBITING CERTAIN TRANSACTIONS WITH IRAN

By the authority vested in me as President by the Constitution and statutes of the United States, including Section 203 of the International Emergency Economic Powers Act (50 U.S.C. 1702), Section 301 of Title 3 of the United States Code, and Section 301 of the National Emergencies Act (50 U.S.C. 1631), in order to take steps additional to those set forth in Executive Order No. 12170 of November 14, 1979, to deal with the threat to the national security, foreign policy and economy of the United States referred to in that Order, and in furtherance of the objectives of United Nations Security Council Resolution 461 (1979) adopted on December 31, 1979, it is hereby ordered as follows:

1-101. The following are prohibited effective immediately, notwithstanding any contracts entered into or licenses granted before the date of this Order:

(a) The sale, supply or other transfer, by any person subject to the jurisdiction of the United States, of any items, commodities or products, except food, medicine and supplies intended strictly for medical purposes, and donations of clothing intended to be used to relieve human suffering, from the United States, or from any foreign country, whether or not originating in the United States, either to or destined for Iran, an Iranian governmental entity in Iran, any other person or body in Iran or any other person or body for the purposes of any enterprise carried on in Iran.

(b) The shipment by vessel, aircraft, railway or other land transport of United States registration or owned by or under charter to any person subject to the jurisdiction of the United States or the carriage (whether or not in bond) by land transport facilities across the United States of any of the items, commodities and products covered by paragraph (a) of this section which are consigned to or destined for Iran, an Iranian governmental entity or any person or body in Iran, or to any enterprise carried on in Iran.

(c) The shipment from the United States of any of the items, products and commodities covered by paragraph (a) of this section on vessels or aircraft registered in Iran.

(d) The following acts, when committed by any person subject to the jurisdiction of the United States in connection with any transaction involving Iran, an Iranian governmental entity, an enterprise controlled by Iran or an Iranian governmental entity, or any person in Iran:

(i) Making available any new credits or loans;

(ii) Making available any new deposit facilities or allowing substantial increases in non-dollar deposits which exist as of the date of this Order;

more

(OVER)

(iii) Allowing more favorable terms of payment than are customarily used in international commercial transactions; or

(iv) Failing to act in a businesslike manner in exercising any rights when payments due on existing credits or loans are not made in a timely manner.

(e) The engaging by any person subject to the jurisdiction of the United States in any service contract in support of an industrial project in Iran, except any such contract entered into prior to the date of this Order or concerned with medical care.

(f) The engaging by any person subject to the jurisdiction of the United States in any transaction which evades or avoids, or has the purpose or effect of evading or avoiding, any of the prohibitions set forth in this section.

1-102. The prohibitions in section 1-101 above shall not apply to transactions by any person subject to the jurisdiction of the United States which is a non-banking association, corporation, or other organization organized and doing business under the laws of any foreign country.

1-103. The Secretary of the Treasury is delegated, and authorized to exercise, all functions vested in the President by the International Emergency Economic Powers Act (50 U.S.C. 1701 _et seq_.) to carry out the purposes of this Order. The Secretary may redelegate any of these functions to other officers and agencies of the Federal government.

1-104. The Secretary of the Treasury shall ensure that actions taken pursuant to this Order and Executive Order No. 12170 are accounted for as required by Section 401 of the National Emergencies Act (50 U.S.C. 1641).

1-105. This Order is effective immediately. In accord with Section 401 of the National Emergencies Act (50 U.S.C. 1641) and Section 204 of the International Emergency Economic Powers Act (50 U.S.C. 1703), it shall be immediately transmitted to the Congress and published in the _Federal Register_.

JIMMY CARTER

THE WHITE HOUSE,
April 7, 1980.

# # # # #

IN ADVANCE OF PRINTED COPY

Title 31 - MONEY AND FINANCE: Treasury

Chapter V - Foreign Assets Control

Department of the Treasury

Part 535 - Iranian Assets Control Regulations

AGENCY: Office of Foreign Assets Control

ACTION: Final Rule

SUMMARY: The Office of Foreign Assets Control is amending the Iranian Assets Control Regulations. The purpose of the amendment is to impose additional prohibitions on dealings with Iran. The need for the amendment is to implement the provisions of Executive Order No.12205, signed by the President on April 7, 1980. The effect of the amendment is that exports to Iran, except those involving food, medicine, medical supplies, or donations of clothing intended to be used to relieve human suffering, are prohibited; restrictions are placed on the shipment of goods to Iran; restrictions are placed on new service contracts with Iran; and restrictions are placed on various financial transactions to which Iran is a party.

EFFECTIVE DATE: April 7, 1980, , e.s.t.

FOR FURTHER INFORMATION CONTACT: Dennis M. O'Connell, Chief Counsel, Office of Foreign Assets Control, Department of the Treasury, Washington, D.C. 20220, Tel. 202/376-0236.

SUPPLEMENTARY INFORMATION: Since the regulations involve a foreign affairs function, the provisions of the Administrative Procedure Act, 5 U.S.C. 553, requiring notice of proposed rule making, opportunity for public participation and delay in effective date are inapplicable.

The United Nations Security Council voted 12-0 on December 31, 1979 to impose economic sanctions on Iran if the American hostages were not freed by January 7, 1980. A resolution mandating economic sanctions was acted upon by the Security Council of the United Nations on January 13, 1980 and would have been adopted but for the veto cast by the Soviet Union.

The resolution called upon all countries to:

a. Prevent the sale or supply by their nationals or from their territories, whether or not originating in their territories, to or destined for Iranian governmental entities in Iran or any other person or body in Iran, or to or destined for any other person or body for the purposes of any enterprise carried on in Iran, of all items, commodities or products, except food, medicine and supplies intended strictly for medical purposes;

b. Prevent the shipment by vessel, aircraft, railway, or other land transport of their registration or owned by or under charter to their nationals or the carriage whether or not in bond by land transport facilities across their territories of any of the items, commodities, and products covered by subparagraph (a)

which are consigned to or destined for Iranian governmental entities or any person or body in Iran, or to any enterprise carried on in Iran;

c. Not make available to the Iranian authorities or to any person in Iran or to any enterprise controlled by an Iranian governmental entity any new credits or loans; shall not, with respect to such persons or enterprises make available any new deposit facilities or allow substantial increases in existing nondollar deposits or allow more favorable terms of payment than customarily used in international commercial transactions; and shall act in a businesslike manner in exercising any rights when payments due on existing credits or loans are not made on time and shall require any persons or entities within their jurisdiction to do likewise;

d. Prevent the shipment from their territories on vessels or aircraft registered in Iran of products and commodities covered by subparagraph (a) above;

e. Prevent their nationals, or firms located in their territories, from engaging in service contracts, in support of industrial projects in Iran, other than those concerned with medical care;

f. Prevent their nationals or any person or body in their territories from engaging in any activity which evades or has the purpose of evading any of the decisions set out in this resolution:

The United States now is implementing the sanctions contemplated by this resolution. The President on April 7, 1980, signed Executive Order 12205 pursuant to the International Emergency Economic Powers Act imposing these sanctions. These regulations are being issued as amendments to the Iranian Assets Control Regulations to implement that order.

In reading these regulations, the following should be considered:

1. The prohibitions involved in these sanctions are listed in §535.206 and §535.207 and are in addition to the sanctions previously imposed under §535.201;

2. All provisions in the form of general licenses, definitions, interpretations and other provisions previously issued under this part and still in effect apply, where relevant, to the sanctions contained in the regulations being published today;

3. Exports to Iran are now governed by the prohibition in §535.207(a) and related provisions. It is expected that overseas subsidiaries of United States persons will not make exports prohibited by these regulations. U. S. parent entities must inform the Office of Foreign Assets Control ten days before any of its subsidiaries proposes to make any export to Iran; and

4. The prohibitions contained in the resolution acted upon by the U. N. Security Council concerning new loans and credits are governed by §535.201, as interpreted by §535.419.

31 CFR, Part 535 is amended as follows:

amended to read as follows:

§535.201 Transactions involving property in which Iran or Iranian entities have an interest.

No property subject to the jurisdiction of the United States or which is in the possession of or control of persons subject to the jurisdiction of the United States in which on or after the effective date Iran has any interest of any nature whatsoever may be transferred, paid, exported, withdrawn or otherwise dealt in except as authorized.

2. §535.203 is amended by the addition of paragraph (f), as follows:

§535.203 Effect of transfers violating the provisions of this part.

* * * * *

(f) For the purpose of this section the term "property" includes gold, silver, bullion, currency, coin, credit, securities (as that term is defined in section 2(1) of the Securities Act of 1933, as amended), bills of exchange, notes, drafts, acceptances, checks, letters of credit, book credits, debts, claims, contracts, negotiable documents of title, mortgages, liens, annuities, insurance policies, options and futures in commodities, and evidences of any of the foregoing. The term "property" shall not, except to the extent indicated, be deemed to include chattels or real property.

3. §535.206 is added as follows:

§535.206 Financial transactions.

(a) Except as authorized by means of regulations, rulings, instructions, licenses or otherwise, no person subject to the jurisdiction of the United States shall, directly or indirectly, in any transaction involving Iran, an Iranian governmental entity, an enterprise controlled by Iran or an Iranian governmental entity, or any person in Iran:

(1) Make available any new deposit facilities or allow substantial increases in existing non-dollar deposits.

(2) Allow more favorable terms of payment than customarily used in international commercial transactions.

(3) Fail to act in a business-like manner in exercising any rights when payments due on existing credits or loans are not made in a timely manner, provided the exercise of such rights is not otherwise prohibited by this part.

(b) The prohibitions contained in paragraph (a) shall not apply to transactions by any person subject to the jurisdiction of the United States which is a non-banking association, corporation or other organization organized and doing business under the laws of any foreign country. The U. S. parent of any such person must report to the Office of Foreign Assets Control any prospective transaction with Iran contained in paragraph (a) ten days before any subsidiary enters into such a transaction.

4. §535.207 is added as follows:

§535.207 Trade, shipping and service transactions.

(a) All of the following transactions are prohibited, except as authorized by means of regulations, rulings, instructions, licenses or otherwise:

(1) The sale, supply or other transfer, by any person subject to the jurisdiction of the United States, of any items, commodities or products, except food, medicine or supplies intended strictly for medical purposes, and donations of clothing intended to be used to relieve human suffering, from the United States, or from any foreign country, whether or not originating in the United States, either to or destined for Iran, an Iranian governmental entity in Iran, any other person or body in Iran, or any other person or body for the purposes of any enterprise carried on in Iran.

(2) The shipment by vessel, aircraft, railway or other land transport of United States registration or owned by or under charter to a person subject to the jurisdiction of the United States or the carriage (whether or not in bond) by land transport facilities across the United States of any of the items, commodities or products covered by paragraph (a) of this section which are consigned to or destined for Iran, an Iranian governmental entity, or any person or body in Iran, or to any enterprise carried on in Iran.

(3) The shipment from the United States of items, products or commodities covered by paragraph (a) on vessels or aircraft registered in Iran.

(4) The engaging, by any person subject to the jurisdiction of the United States, in any service contract in support

of industrial projects in Iran, except any such contracts entered into prior to the effective date or concerned with the provision of medical services.

(b) The prohibitions contained in paragraph (a) shall not apply to transactions by any person subject to the jurisdiction of the United States which is a non-banking association, corporation or other organization organized and doing business under the laws of any foreign country. The U. S. parent of any such person must report to the Office of Foreign Assets Control any transaction with Iran contained in paragraph (a) ten days before any subsidiary enters into such a transaction.

5. §535.208 is added as follows:

§535.208 Evasions; effective date.

(a) Any transaction for the purpose of, or which has the effect of, evading or avoiding any of the prohibitions set forth in this subpart is hereby prohibited.

(b) The term "effective date" means, with respect to transactions prohibited in section 535.201, 8:10 a.m. eastern standard time, November 14, 1979, and with respect to the transactions prohibited in Sections 535.206 and 535.207, eastern standard time, ~~March 31~~ April 7, 1980.

6. Subpart C is amended by the addition of §§535.308 and 535.331 as follows:

Subpart C - General Definitions

*   *   *   *   *

§535.308 Person.

The term "person" means an individual, partnership, association, corporation or other organization.

*   *   *   *   *

§535.331 Food.

The term "food" as used in §535.207(a) shall include commodities directly consumed by humans or by animals when such animals are primarily used as a source of food.

7. Subpart D is amended by the addition of §§535.401, 535.402, 535.403, 535.419(e), 535.421, 535.422, 535.423, 535.424 and 535.425, as follows:

Subpart D - Interpretations

§535.401 Reference to amended sections.

Reference to any section of this part or to any regulation, ruling, order, instruction, direction or license issued pursuant to this part shall be deemed to refer to the same as currently amended unless otherwise so specified.

§535.402 Effect of amendment of sections of this part or of other orders, etc.

Any amendment, modification, or revocation of any section of this part or of any order, regulation, ruling, instruction, or license issued by or under the direction of the Secretary of the Treasury pursuant to section 203 of the International Emergency Economic Powers Act shall not, unless otherwise specifically provided, be deemed to affect any act done or omitted to be done, or any suit or proceeding had or commenced in any civil or criminal case, prior to such amendment, modification, or revocation and all penalties, forfeitures, and liabilities under any such order, regulation, ruling, instruction or license shall continue and may be enforced as if such amendment, modification, or revocation had not been made.

§535.403 Termination and acquisition of an interest of Iran or an Iranian entity.

(a) Whenever a transaction licensed or authorized by or pursuant to this part results in the transfer of property (including any property interest) away from Iran or an Iranian entity, such property shall no longer be deemed to be property in which

Iran or an Iranian entity has or has had an interest, unless there exists in the property another such interest the transfer of which has not been effected pursuant to license or other authorization.

(b) Unless otherwise specifically provided in a license or authorization contained in or issued pursuant to this part, if property (including any property interest) is transferred to Iran or an Iranian interest, such property shall be deemed to be property in which there exists an interest of Iran or an Iranian entity.

* * * * *

§535.419 Extensions of credit to Iran.

* * * * *

(e) The prohibition in §535.201 does not apply to extensions or renewals of credits to Iran or an Iranian entity by any person subject to the jurisdiction of the United States which is a non-banking association, corporation or other organization organized and doing business under the laws of any foreign country.

* * * * *

§535.421 Prior contractual commitments not a basis for licensing.

Specific licenses are not issued on the basis that an unlicensed firm commitment or payment has been made in connection with a transaction prohibited by this part. Contractual commitments to engage in transactions subject to the prohibitions of this part should not be made, unless the contract specifically states that the transaction is authorized by general license or that it is subject to the issuance of a specific license.

§535.422 New deposit facilities.

(a) The prohibition contained in §535.206(a) includes the opening of any new accounts as well as the acceptance of non-dollar deposits in any existing accounts where the resulting balance would be substantially greater than that existing on the effective date.

(b) A balance is substantially greater if it is more than 10% greater than the average daily balance during the six-month period prior to the effective date of §535.206.

(c) An account is not a new account if it is established as a result of a transfer authorized by §535.508 or otherwise licensed under this part.

§535.423 Customary international commercial terms.

(a) §535.206(b) prohibits the sale to Iran, any Iranian entity or any person in Iran of any commodity on conditions markedly different from those customarily offered by other sellers of that commodity in terms of price, method of payment and time of payment.

(b) This section shall not be construed to authorize any transaction which is otherwise prohibited by this part.

§535.424 Service contracts in support of industrial projects in Iran.

Specific licenses to enter into any service contract in support of any enterprise in Iran will be considered on a case-by-case basis. No service contract should be entered into without a specific license.

§535.425 Iranian enterprise.

For purposes of §535.206, the term "enterprise" means any business or commercial activity or venture of any kind whatsoever, whether operated or organized as a corporation, partnership, joint venture, association, sole proprietorship, or otherwise.

is amended by the revocation of §535.533, and the addition of §§535.572 and 535.574, as follows:

Subpart E - Licenses

* * * * *

§535.533 [Revoked].

* * * * *

§535.572 Authorization of exports of certain types of goods to Iran.

All transactions not inconsistent with §535.419 and ordinarily incident to the export to Iran of the following types of goods are hereby authorized:

(a) Medicines and supplies intended strictly for medical purposes.

(b) Food.

(c) Donations of clothing intended to be used to relieve human suffering.

* * * * *

§535.574 Service contracts in support of telecommunications in Iran.

Specific licenses will be considered for transactions incident to telecommunications with Iran.

epartment of the TREASURY
NEWS
SHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. April 8, 1980

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $7,000 million, to be issued April 17, 1980. As the regular 13-week and 26-week bill maturities were issued in the amount of $6,278 million, this offering will provide the Treasury about $700 million new cash above the amount maturing through the regular issues. The $4,001 million of additional issue 43-day cash management bills issued March 5 and maturing April 17, 1980, will be redeemed at maturity.

The $6,278 million of regular maturities includes $1,003 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,432 million currently held by Federal Reserve Banks for their own account. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,500 million, representing an additional amount of bills dated January 17, 1980, and to mature July 17, 1980 (CUSIP No. 912793 4W 3), originally issued in the amount of $3,243 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,500 million to be dated April 17, 1980, and to mature October 16, 1980 (CUSIP No. 912793 5K 8).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing April 17, 1980. Tenders from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities will be accepted at the weighted average prices of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents of foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, April 14, 1980. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

M-420

Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held at the close of business on the day prior to the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering; e.g., bills with three months to maturity previously offered as six month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $500,000 or less without stated price from any one bidder will be accepted in full at the weighted average price (in three decimals) of accepted competitive bids for the respective issues.

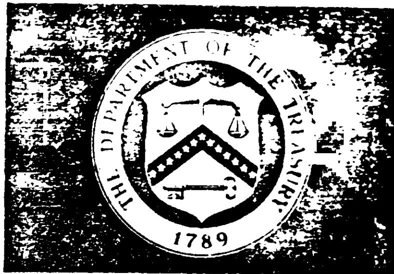
Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on April 17, 1980, in cash or other immediately available funds or in Treasury bills maturing April 17, 1980. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

rtment of the TREASURY
GTON, D.C. 20220 TELEPHONE 566-2041

NEWS



IMMEDIATE RELEASE
April 10, 1980

Contact: Everard Munsey
202/566-8191

CHRYSLER LOAN GUARANTEE BOARD REPORTS TO CONGRESS

The Chrysler Corporation Loan Guarantee Board -- Secretary of the Treasury G. William Miller, Federal Reserve Board Chairman Paul Volcker, and Comptroller General Elmer Staats -- today submitted its first report to Congress, for the period ended March 31, 1980.

The Board said that since the Loan Guarantee Act was passed on December 21 Chrysler has "made considerable progress... but the seriousness of its situation is not to be underestimated."

The report said Chrysler has "moved forward toward meeting the Act's requirements" and has submitted revised operating and financing plans as well as the required plans for energy savings, productivity improvements, and employee stock ownership. All are under review in various stages.

The Board reported that it had held five meetings through March 31. Staff support for the Board is being provided primarily by the Treasury Department with aid from senior staff from the General Accounting Office and the Federal Reserve System and private legal and financial consultants.

The report was transmitted to Congress yesterday. The text of the report is attached.

# # #

M-421

March 31, 1980

CHRYSLER CORPORATION LOAN GUARANTEE BOARD

REPORT TO CONGRESS FOR THE PERIOD THROUGH MARCH 31, 1980

INTRODUCTION

Section 14(a) of the "Chrysler Corporation Loan Guarantee Act of 1979" (the "Act") requires the Chrysler Corporation Loan Guarantee Board to report on its activities to the Congress semiannually in fiscal years 1980 and 1981, and annually every fiscal year thereafter in which there are outstanding guaranteed loans or commitments issued by the Board. This, the first of the Board's reports, covers the period from enactment on January 7 through March 31, 1980.

This report is divided into four sections: first, how the Board is organized to implement the Act; second, Chrysler Corporation's current operational and financial condition; third, Chrysler's efforts to comply with the nonfinancing provisions of the Act; and fourth, the company's efforts to assemble the $1.43 billion in sales of assets and in unguaranteed private financing assistance from its constituents before the Board can provide Chrysler Federal guarantees.

Chrysler has made considerable progress since the Act was passed, but the seriousness of its situation is not to be underestimated. It has developed improved operating and financing plans, and has moved forward toward meeting the Act's requirements for unguaranteed financing assistance.

THE TERMS OF THE ACT

The Guarantee Act established a five-member Board to implement its terms. The Board is comprised of three voting members, and two ex officio non-voting members. The voting members are the Secretary of the Treasury, as Chairperson, the Comptroller General of the United States and the Chairman of the Board of Governors of the Federal Reserve System. The non-voting members are the Secretary of Labor and the Secretary of Transportation.

The Act authorizes the Board to guarantee up to $1.5 billion principal amount of loans (plus interest thereon) for the benefit of the Chrysler Corporation only if certain conditions are met. Among the more significant pre-conditions, the Board must determine that:

- Chrysler's operating plan demonstrates that the company can continue as a going concern through 1983 with the guarantee program and, also, that it can continue to do so thereafter without additional Federal assistance; and that these plans are reasonable and feasible.

- The company's financing plan meets the needs of the operating plan, and is reasonable and feasible. This plan must include at least $1.43 billion required proceeds from sales of assets and in unguaranteed financing assistance. The Act establishes targets for domestic and foreign creditors, State and local governments, and suppliers, dealers, and others with a stake in the future of the company, although the Board may modify compliance with specific targets. There must also be firm commitments or adequate assurance that all required proceeds from sales of assets and unguaranteed financing have been or will be received to meet the aggregate goals set by the statute.

- The labor unions that represent Chrysler's employees have agreed to provide $462.5 million in wage concessions for the period September 14, 1979 to September 14, 1982; and Chrysler has adopted a program for achieving at least $125 million concessions from its nonunionized employees.

- The collateral received by the Government for its guarantees, together with Chrysler's prospective earning power, furnish reasonable assurance of repayment of the guaranteed loans.

- Employee stock ownership is provided through establishment of an employee stock ownership plan. Also, $100 million of stock must be made available for purchase by employees and their unions.

Other requirements include adoption of an energy savings plan and a productivity improvement plan. These are discussed below.

ACTIVITIES OF THE GUARANTEE BOARD

The Board began its formal efforts to implement the Act shortly after the Act was signed on January 7, 1980. Since January, the members of the Board, as well as their senior staff, have devoted substantial time and effort to implementation of the Act.

The Board has held five meetings to date. Its members have met with Chrysler Board Chairman Iacocca, members of his senior management, and his outside advisors, as well as with representatives of certain of the constituents required to participate in the unguaranteed long-term financing.

The Board has relied primarily on staff support provided by the Treasury Department. To organize the various activities, the Board appointed a General Counsel and an Executive Director/Secretary, both from the Treasury. In addition, to assure maximum coordination between the voting members of the Board, senior staff from the

General Accounting Office and the Federal Reserve System have been detailed to work full time with the Board's staff. Additional staff work, including the analysis, documentation and recommendations for Board actions, is provided by Treasury's Office of Chrysler Finance. Also aiding the analytical effort are the private consultants who worked with the Administration last fall: the public accounting/management consulting firm of Ernst & Whinney, and John C. Secrest, a former financial vice president of American Motors Corporation. The Board has also engaged the New York City law firm of Cahill Gordon & Reindel to assist on legal matters. The Board's staff has met on a weekly basis with Chrysler in both Washington and Detroit, and is in constant communication with them.

CHRYSLER'S RECENT OPERATIONS AND CURRENT SITUATION

In the past year Chrysler experienced financial difficulties. The passage of the Act offered the company and its constituents access to additional financial resources thereby alleviating some of the pressures on the company. The expectation of Federal assistance has enabled Chrysler to obtain interim private financing assistance to continue its operations while developing the operating and financing plans and assembling the unguaranteed financing needed to meet the other terms of the Act, as illustrated below:

- $100 million in interim financing from a short-term loan from PSA/Peugeot-Citroen, conditioned on receipt of an option to purchase Chrysler's stock interest in Peugeot in the event a long-term relationship between the two companies is not negotiated.

- $146 million in additional financing of imports from Mitsubishi Motors Company.
- $175 million from deferral of January, February and March supplier and vendor payments into April, May, and June respectively.

These measures more than offset the cash flow impact of projected first quarter losses and, by mid-February, Chrysler indicated that it might continue to operate for quite some time without drawing down significant Federal assistance.

Chrysler currently estimates its 1980 losses could be between $550 million and $650 million. Sales of domestically-produced Chrysler vehicles, in line with the sales of most domestically produced vehicles, have been below forecast. Recent sharp increases in interest rates, reduced credit availability, and uncertainty over the state of the economy have further complicated the situation by impairing prospects for future sales while increasing Chrysler's and its dealers' operating and financing costs. Additional interim financing may therefore soon be necessary.

PROGRESS IN MEETING THE REQUIREMENTS OF THE ACT

Before addressing Chrysler's operating and financing plans, the progress made by Chrysler and others to meet the numerous requirements of the Act will be reviewed.

Report Requirements

The Act requires certain agencies to submit reports on specified subjects. The Board's staff began meeting with each agency in early January to coordinate the efforts of each, and assure timely completion of those relevant to the determinations required from the Board. These have been satisfied or are progressing:

- Small Business Administration Study. The Act requires the Small Business Administration (SBA) to study the financial problems faced by small business automobile dealers, determine what assistance through Federal loans and loan guarantees may be needed and can be made available to alleviate such problems, and to report on the study to the Congress within 60 days.

  SBA submitted its report to the Congress and the Board on March 7, 1980. It describes the overall decline of all dealerships, with a substantial increase in closings in 1979 offsetting an increase in the number of import car dealers. Financial problems are attributable to the reduction in domestic car sales and price increases, and the high cost of financing dealer inventory. The report emphasizes that while guaranteed term loans could be made to dealers, their financial problems could only be solved by a reduction in the inflation rate and the increased availability from domestic producers of the types of fuel efficient cars desired by consumers.

  The report indicates that the financial problems are more acute for Chrysler dealers, due to Chrysler's problems and their relatively fewer sales per dealer.

- Department of Transportation Study. The Act requires the Department of Transportation (DOT) to conduct a six-month study of the auto industry, and Chrysler's viability in it, and the impacts on regions of the country of various energy and economic assumptions. The Act requires that the report be submitted to Congress by July 7, 1980 -- within 180 days after enactment. The Board's staff has worked closely with DOT and expects an interim report in early April and a full draft report by late April or early May. DOT is coordinating its efforts closely with those of the Board's staff, which has made its consultants' analyses available to DOT.

- EPA Regulations The Act requires the Environmental Protection Agency (EPA) to promulgate within 60 days of enactment regulations on the inclusion of electric vehicles in the CAFE requirements. The Department of Energy is then to conduct a seven-year evaluation of the proposed inclusion. EPA provided a preliminary draft to the Board staff on March 17, and intends to promulgate the regulations in draft during April These regulations are apt to have no impact on Chrysler during the foreseeable future.

Requirements of Chrysler

The Act imposes four additional requirements on Chrysler as follows:

Energy Savings Plan

A draft Energy Efficiency Plan was submitted by Chrysler to the Board's staff in early February. Comments were obtained from other interested agencies -- EPA, DOT, NHTSA and the Department of Energy -- and were provided to Chrysler which revised its plan in response to those comments. A revised plan was submitted to the Board on March 7. The Board is currently studying this plan in connection with its review of Chrysler's operating and financing plans.

The key elements of the Chrysler plan, which indicates that the company will reduce total fleet lifetime petroleum consumption by 89,500,000 barrels in the 1985 model year, compared with its 1974 products, follows:

- Major product changes that will increase the efficiency of its vehicles and, thus, reduce energy consumption. Some of these are discussed below in greater depth in the context of Chrysler's operating plan and product program.
  - Autos: Reduced vehicle weight and engine size, so as to improve fuel efficiency by 5 miles per gallon for the 1979 to 1980 period and projected to increase it by an additional 5 miles per gallon by 1985. From

1974-1985, the company's fleet fuel efficiency will have risen 89%, with a 34% improvement taking place during the 1980-1985 period. Federal regulatory requirements are planned to be met throughout.

- Trucks: Instituted similar programs, which increase its fuel efficiency approximately 25% over the 1980-1985 period. Federal regulatory requirements are not projected to be met in two of the five years, because of the lead time necessary while the company develops new smaller truck lines.

- Manufacturing facility changes to reduce fuel consumption, by conversion from oil to other fuels and increased efficiency for all plants.

Productivity Improvement Plan

The Act requires Chrysler to submit, as part of its operating plan, a productivity improvement plan detailing actions to increase its productivity. Chrysler submitted such a plan to the Board on March 4. The Board has the plan currently under review.

The plan projects a 21.3 percent improvement in total productivity by 1983 over 1979 measured by reference to labor hours. This increase results primarily from manufacturing process improvements and fixed manpower reductions, and includes both labor and nonlabor related improvements.

Employee Stock Ownership Plan

The Act requires Chrysler to adopt an employee stock ownership plan into which it is to deposit $162.5 million in Chrysler common stock under specified provisions. This stock is to be provided in consideration of the wage concessions agreed to by the company's employees.

Chrysler provided a revised draft plan to the Board which it developed after consultation with its unionized employees and Board staff. On March 19, Chrysler submitted the plan to the Internal Revenue Service for review. The Board has not yet determined whether the present ESOP proposal satisfies the Act.

THE OPERATING PLAN

Since the Act was passed, Chrysler has undertaken a substantial revision of its long-term product plans. On February 25, it submitted to the Board a new "Preliminary Operating Plan" which projects a 1980 loss of approximately $500 million and a return to profitability in 1981. In addition, the company has reorganized and strengthened its management and retained management consultants and financial advisors to assist it in developing its operating and financing plans. It has also obtained the agreement of its unions to provide the concessions required by the Act, and has adopted a plan to obtain the required concessions from non-union employees.

The revised operating plan reflects major changes and improvements from the plan prepared in October. The salient points of the revised plan follow:

- Acceleration of the introduction of new small fuel-efficient cars and trucks. By model year 1985, the company will produce and sell only smaller front-wheel drive cars and trucks which will be predominantly powered by four-cylinder engines.
- Introduction of the first of the plan's new vehicles, the K-car, is scheduled for this coming fall. It is a four-cylinder front-wheel drive fuel-efficient automobile. The company's viability in the coming years depends on its success in building and selling the K-car at a profit.

- A reduction in the number of distinct vehicle lines from last year's level. The company's automobile platforms will drop from five to three. Large trucks will be dropped from the company's vehicle offering and replaced with small fuel-efficient trucks based upon the new car platforms.

- Increased commonality of parts from the reduction in the number of platforms, which will reduce the number of distinct major components, such as engines and transaxles, resulting in improved efficiency and servicability.

- Fixed costs will be held nearly to the 1979 level, while the volume of production is increasing.

- Variable costs over the base year will be reduced by $2.2 billion on the company's vehicles. Actions to be taken include a general tightening of control by management in such areas as equipment changes, design cost reductions, development of components internally and streamlined purchasing practices.

- Reductions in fixed and variable costs will lower the company's breakeven level of production, thus increasing profit potential and reducing the company's vulnerability to economic and market fluctuations.

- Capital spending in the 1979 to 1985 period will be reduced by almost $1 billion from the level assumed last fall to $12.6 billion. Most of the savings will be realized in 1984 and 1985.

- Management control and information systems have been improved to assure implementation of planned programs and to permit the company to anticipate problems and react to them in a timely manner.

In our view, the revised operating plan represents a first :ep for Chrysler's return to long-term commercial viability. ıe Board's staff has not yet completed a final evaluation of the .an, nor has it reached any final conclusions. However, preliminary ıdications are that substantial adjustments to the plan may be :cessary.

- The plan's projected 1980 loss of approximately $500 million appears too low in light of the company's first quarter performance. Chrysler currently estimates that its loss for the year could be

between $550 million and $650 million. To date this year, Chrysler's market share has been substantially below forecast, although total sales have been higher than forecast because of a larger total market.

- The company's estimate of the size of the auto market for later years of the plan may be too optimistic. Chrysler's plan forecasts total U.S. car sales for 1981 and 1982 at 11.0 million and 12.1 million units, respectively. In contrast, the median forecast of Data Resources, Chase Econometrics, and Wharton is 9.9 million and 10.6 million units respectively.

- The company expects to be able to increase the wholesale prices of its new small fuel-efficient vehicles faster than the rate of inflation for all years covered by the plan.

- Chrysler's goal is to attain improvements in variable margin resulting in a very large increase in gross margins by 1983.

- The plan projects constant fixed costs in real terms for the company despite major increases in planned volumes.

- The plan assumes that continued erosion in the size of its dealer network will have no effect on the company's sales results, despite the reduced market coverage.

Lower profits in the plan years would increase the financing needs of the company in general and the demand for Federally guaranteed assistance, in particular. Each dollar of reduced profit in the near term approximately will result in a dollar of increased financing need for Chrysler if it is to continue its present product development programs.

At the request of the Board's staff, Chrysler and its consultants have identified alternative measures which the company could implement to reduce the financing needs if there were a deterioration in operations from the plan projections. Once the

Guarantee Board has completed its analysis of the current operating plan and its contingency plan; it will be in a better position to assess whether some or all of those alternative actions should be included in the basic plan.

FINANCING PLAN

Chrysler has also submitted a Preliminary Financing Plan, dated February 27, 1980, to meet the financing needs generated by its Operating Plan and which details the company's strategy for raising these funds. The Operating Plan projects that the company will require cumulative funding peaking at $2.3 billion in 1982, which declines to $700 million by 1985. To this need the Financing Plan adds $177 million of Canadian capital expenditures which are not in the Operating Plan and $1.0 billion of financing contingency reserves which grow to $2.3 billion by 1985. As Chrysler's plans have developed over the past six months, its assumptions have been altered. As a result, the potential financing need of $3.0 billion which was cited in the Administration's November testimony is not directly comparable to the figures in the new plan.

The Preliminary Financing Plan projects financing through 1983 of approximately $3.5 billion to meet the adjusted operating cash need and the $1 billion financing contingency. The financing plan provides five basic parts:

- $1.689 billion from the long-term financing package that Chrysler proposes to meet the requirements of the Guarantee Act for constituent contributions and concessions and the proceeds of the sales of assets.

- $429 million from additional pension fund payment deferrals.
- $716 million through 1983 for its foreign operations: $646 million from the Canadian Government and $70 million for its Mexican operations. (The Plan projects an additional $25 million in loans from Canada in 1984.)
- $677 million in preexisting debt that was scheduled to mature or be renewed in 1980, but which must continue in place under the terms of the Act.
- Federal guaranteed loans of only $200 million on a temporary basis during the second and third quarters of 1980. Since these loans are projected to be repaid by yearend 1980, the funds are not reflected in the $3.5 billion total. The company asserts the need for the full $1.5 billion in commitments to provide a reserve against the risks inherent in its operating and financing plans.

In light of the risks to achieving planned projections, the potential need for Federal assistance is significantly underestimated. The Board's staff is still analyzing the plan and has not reached judgments at this time because of the uncertain status of the current negotiations to achieve the company's long-term financing plan and the need for further review of its operating plan.

Unguaranteed Financing Sources

The Preliminary Financing Plan submitted on February 27 proposes to raise the unguaranteed funds in a manner somewhat different from the statutory objectives. As a result, the company has indicated it will ask the Board to modify the statutory targets among types and sources of funds for the $1.43 billion total from sales of assets and unguaranteed financing assistance. Under the Act, the Board has the authority to make appropriate modifications. A comparison of the targets set by the statute and the sources proposed by Chrysler follows:

Nonfederal Financing Assistance
Constituent Contributions and Concessions
($ millions)

	Guarantee Act Targets	Chrysler 2/27 Plan	Difference
State, local and other governments*	$ 250	$ 299	$ 49
Suppliers and dealers			
Contributions & concessions	130	230	100
Capital investments	50	0	(50)
Additional equity	50	0	(50)
Asset dispositions	300	510	210
Banks and other financial institutions			
Domestic Creditors:			
-- New credits (extended maturities and deferred interest)	400	209	(191)
-- Concessions	100	122	22
Foreign creditors:			
-- New credits (extended maturities and deferred interest)	150	209	
-- Concessions	--	110	169
Total	$1,430	$1,689	$ 259

As discussed below, the current status of negotiations does not provide a basis for determining whether the plan will be achieved and would be consistent with the statutory requirements.

State, Local and Other Governments

The Act calls for at least $250 million in assistance from State, local and other governments. While significant progress has

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* Canadian Government assistance is not yet sufficiently assured to be included here.

been made in some States the company has not yet received any funds and is still in the process of obtaining firm commitments for much of the package. Most of this financing will be at market rates and partially or fully collateralized by some of Chrysler's best assets, thus reducing substantially the risk to these lenders. Waivers are required from certain of Chrysler's lenders in order to permit the pledging of assets to secure the loans by State and local governments. The Appendix describes the status of Chrysler's efforts in each jurisdiction at the date of this report.

Suppliers and Dealers

Chrysler proposes to sell subordinated debentures to meet the Act's target for at least $180 million of financing assistance from suppliers, dealers and others with a stake in its future. The company has filed a prospectus with the SEC and is offering for sale $400 million of these securities. It began soliciting purchase orders on March 12 and expects to complete the offering in April. All subscriptions are subject to confirmation after the Board has issued its commitment. A substantial portion of the proceed may be received in monthly installment payments over two years. Chrysler projects proceeds of at least $230 million from this source and has proposed that the Board accept the $100 million of such proceeds as satisfying the targets in the Act for capital and the sale of new equity described below. As of March 31, Chrysler reported that it had conditional subscriptions or indications of interest for approximately $65 million from its dealers and suppliers toward the $230 million goal.

The Act requires that at least $50 million of the $180 million be in the form of "capital", which the Act defines to include funds on which no interest or dividends are paid so long as guaranteed loans are outstanding. The debentures, however, do not meet the capital definition because they are to bear interest at 12 percent. Chrysler's investment bankers state that the company is unable to obtain noninterest, nondividend bearing funds from its dealers, suppliers, and others at this time, and thus Chrysler proposes that the Board modify the target for capital.

Equity

The Act, as indicated, calls for an additional $50 million in new equity investments by nonfederal sources, but does not permit the payment of dividends on Chrysler securities while guarantees are outstanding. Chrysler's advisors believe that it is not possible to sell nondividend bearing equity. Therefore, the company proposes that the Board waive this requirement, and substitute $50 million of the $230 million in subordinated debentures included in its plan.

Asset Dispositions

The Act calls for at least $300 million in proceeds from asset dispositions. Chrysler's plan envisions sales that would result in proceeds of $510 million:

	$ million
Chrysler Financial Corporation (51%)	$320
Foreign subsidiaries of CFC	14
Foreign subsidiaries of parent	45
Real estate	31
Nonrecourse term loan from Peugeot secured by Chrysler's common stock in Peugeot	100
Total	$510

Although a portion of the items may not be counted toward the target because the proceeds would not pass to the parent company, this $510 million component is well in excess of the statutory goal. Chrysler proposes that the excess be counted against the shortfalls described below for creditor assistance.

Chrysler has sold or entered sales agreements for approximately $150 million, including the secured loan from Peugeot. For the rest, it appears that Chrysler will not have firm commitments and will propose that the Board accept letters of intent or corporate resolutions as evidence of assurance that the proposed sale will occur.

Among those sales for which firm agreements are not in place is the principal asset to be sold: Chrysler Financial Corporation, (CFC), the company's wholly owned financing subsidiary. In the past, Chrysler's domestic bank lenders have stated that the sale of 51 percent of CFC or a restructuring of its financing is a precondition for their participation in the financing plan to insulate CFC and the subsidiary's creditors from the financial problems of the parent and a potential lien in favor of the Pension Benefit Guarantee Corporation for the parent's unfunded pension fund liabilities.

Banks and Other Financial Institutions

The Act calls for at least $650 million from existing lenders and creditors: $500 million from domestic creditors, of which $400 million is to be in new credits and contributions and $100 million in concessions; and $150 million from foreign creditors.

The statute requires these amounts to be in excess of loan commitments outstanding on October 17, 1979.

Chrysler has not received commitments from any financial institutions to meet these targets, but it is actively negotiating with its creditors. The current negotiations suggest several issues which will need to be resolved:

- Allocation among the lenders. Chrysler's domestic lenders have indicated that they will not provide the full $500 million themselves. They have proposed that all lenders participate in the $650 million on a basis proportionate to the loans which were actually outstanding on October 17, 1979.

- Form of Bank Participation. Chrysler's plan has not proposed, and the banks have thus far declined to provide, additional cash. Instead, their assistance would be limited to interest concessions and deferral of interest and principal payments.

- Chrysler Financial Corporation. The domestic banks have been conditioning their participation on the sale of 51 percent of Chrysler Financial Corporation or a restructuring of its financing for the reasons previously stated. Neither the sale nor the restructuring has been negotiated. As a result, it may be difficult to obtain adequate assurance of the banks' contributions until this sale or restructuring is near consummation. Furthermore, any sale or restructuring of CFC will likely involve continuing obligations of Chrysler to CFC. Thus, the overall contribution by the lenders must be evaluated in conjunction with arrangements negotiated for the CFC sale or restructuring.

- Preexisting commitments and loans. The Act effectively provides that only amounts in excess of commitments outstanding on October 17, 1979, are to be considered in meeting the targets of the Act. Chrysler's October plan indicated that, on that date, there were $245 million more available in foreign and domestic loans and loan commitments than are now available: $159 million in unused commitments under the domestic revolving credit; $8 million in credits from other domestic banks; $68 million under a revolving credit with Canadian banks; and $10 million in credits to Chrysler Canada Leasing by other Canadian banks.

> The domestic banks' position, as reported to the Guarantee Board, has been that they would not provide the $159 million since Chrysler could not meet the conditions of the commitments on October 17. Thus, they have stated that effectively there was no commitment.
>
> Chrysler's financing plan assumes the domestic commitment would be replaced by $159 million in proceeds from asset sales in excess of the Act's target. It assumes that the Canadian shortfall would be met by a $68 million line of backup credit which may be guaranteed by the Canadian Government and may not be used. It also states that the $8 million short-fall in domestic bank lines should not be included, since erroneously included as outstanding in the October 17 plan.

The question of timing in completing an acceptable financing agreement with the domestic banks is the keystone of Chrysler's financing program. The European and Japanese creditors are both reportedly waiting for a decision by the domestic banks before they reach a decision on their own participation. The Canadians are also waiting for that decision, as well as for a decision by the Canadian Government.

Other Financing

Other aspects of the plan also raise significant issues that the Board is now addressing:

> Canada. Chrysler's plan assumes $671 million in assistance from Canada: $500 million in loan guarantees and $171 million in grants. Chrysler has not proposed to count any of this against the targets of the Act because of the uncertain timing of commitment and receipt. The Canadian Government has made no decision on providing assistance, but its Minister for Industry, Trade and Commerce has publicly stated that any aid offered to Chrysler probably would be less than requested in the plan.
>
> Mexico. The financing plan assumes the receipt in 1980 of a $70 million term loan to meet the requirements of its Mexican engine plant. The company is currently seeking

guarantees from the Export-Import Bank. It has not, however, proposed that this loan be counted against the targets because it is not assured. If not received, Mexican investments may have to be met from the parent company's other financing sources, unless financed in Mexico.

Import financing. Several issues are raised by Chrysler's financing transactions with a syndicate of Japanese banks and Mitsubishi Motors Corporation (MMC) to finance the company's import of vehicles from MMC. On October 17, 1979, Chrysler had commitments from the Japanese banks for $400 million in import financing using 180-day letters of credit. The Japanese banks terminated the credit agreement; approximately $156 million presently remains outstanding, down from $168 million. Completion of the financing package will require resolution of the pending issues between Chrysler, MMC and the Japanese banks. Chrysler is considering other financing means which would essentially be on a fully secured basis.

Security

The Act requires the Board to require security for the loans to be guaranteed at the time the commitment to guarantee is made. At the time a guarantee is actually issued, the Act requires the Board as a condition of issuance to determine that the prospective earning power of the company, together with the character and value of the security pledged, provide reasonable assurance of the repayment of the loan to be guaranteed.

The Board is currently pursuing the security package in order to obtain collateral adequate to meet all reasonable risks on the potential commitment and to achieve the intent of the priority for the guaranteed loans created by the Act. Chrysler's approach to date has been to offer $1 in security for every $1 in guarantees as such guarantees are issued.

Attachment

Summary of Other Governmental Assistance
From Eight States and One City
(Dollars in millions)

ATION	TYPE OF CREDIT	STATUS
higan:	$150 secured loan $5 property sale	- legislation enacted - terms under negotiation
roit:	$29 lease with pur-chase option	- dependent on Federal grant - initial application was denied; but terms ar under negotiation
iana:	$32 secured loan from bank insurance fund	-legislation enacted -legal issues raised by State attorney general that may frustrate proposal
souri:	$25 secured loan	-legislation required; new proposal under negotiation
inois:	$20 guaranteed loan	-legislation introduced
o:	$14 sale/leaseback $6 property sale	-legislation required; new proposal under negotiatio
York:	$10 secured loan	-initial proposal denied; new proposal under negotiation
aware:	$5 secured loan	-legislation enacted -terms under negotiation
bama:	$3 loan guarantees	-initial proposal denied; new proposal under negotiation
Total	$299	

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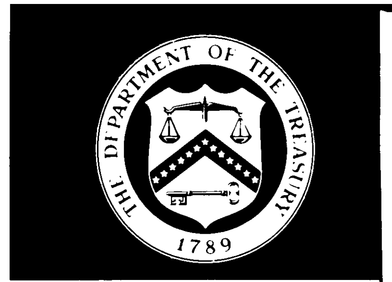

FOR IMMEDIATE RELEASE
April 10, 1980

Contact: George G. Ross
202/566-2356

TREASURY SEEKS PUBLIC COMMENT ON TAX TREATMENT OF FOREIGN EXCHANGE GAINS AND LOSSES

The Treasury Department today issued a series of questions about the appropriate tax treatment of foreign exchange gains and losses. In so doing, the Treasury is expressing no position as to the state of existing law. Instead, the Treasury is requesting public comment to determine whether clarification or modification is needed and, if so, the nature of such clarification or modification.

Persons interested in offering comments on the issues raised in the attached paper are invited to send their comments in writing to H. David Rosenbloom, International Tax Counsel, U.S. Department of the Treasury, Room 3064, Main Treasury Building, Washington, D.C. 20220.

Written comments should be received by August 31, 1980, in order to be sure that they will be taken into account in the formulation of any proposal.

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M-422

ISSUES RELATED TO THE APPROPRIATE TAX TREATMENT OF FOREIGN EXCHANGE GAINS AND LOSSES

The Treasury Department is considering the appropriate tax treatment of gains and losses attributable to foreign exchange rate fluctuations. As an aid to determining whether proposals are desirable in this area, the Treasury would appreciate receiving comments on the issues and examples listed below as well as any other related issues which require attention. In raising these issues, the Treasury is not expressing any position as to their resolution under existing law.

I. Taxpayers Normally Keeping Accounts in Dollars

A. Recognition. When should a taxpayer who normally transacts business and keeps accounts in dollars recognize foreign exchange gain or loss?

1. Should such a taxpayer who lends foreign currency recognize gain or loss upon repayment of the loan? Or should recognition await sale or exchange of the foreign currency proceeds for dollars, another currency or other property?

2. Should such a taxpayer borrowing foreign currency recognize gain or loss on repayment of a loan? Should a taxpayer be able to defer recognition of such a gain by reducing its basis in appropriate assets?

3. If a taxpayer contracts to purchase foreign currency under a forward exchange contract at a specified exchange rate and subsequently takes delivery of the foreign exchange under the terms of that contract, should a gain or loss be recognized upon the purchase? If not, upon what dispositions or uses of the foreign currency should gain or loss be recognized?

B. Character. Should foreign exchange gains and losses be ordinary or should they be capital? To what extent should present Internal Revenue Code rules designed to deal with special securities and commodity transactions (e.g., short sales, holding periods, options) apply to foreign currency?

1. If a U.S. taxpayer hedges the foreign currency exposure of a foreign subsidiary through a forward exchange contract, should gain or loss attributable to the contract be ordinary or should it be capital? Should the character of the gain or loss depend on whether the contract is performed, sold or exchanged, or cancelled with compensation?

2. If a creditor recognizes foreign exchange gain or loss on repayment of a foreign currency loan, what rules should determine the character of the gain or loss? Should the gain or loss be treated as an adjustment of interest income?

3. If a borrower recognizes foreign exchange gain or loss on repayment of a foreign currency loan, what rules should determine the character of the gain or loss? Should the gain or loss be treated as an adjustment of interest expense? As gain or loss on a short sale?

C. Source. Should foreign exchange gains and losses be domestic source or should they be foreign source?

1. If foreign exchange gain is recognized by a creditor on repayment of a foreign currency loan, what rules should determine the source of such gain? If a loss is recognized, how should that loss be allocated or apportioned?

2. How should analogous gains and losses of a borrower on repayment of a foreign currency loan be sourced?

3. What source rules should determine the source of gain or loss recognized under alternative methods (e.g., performance, sale or exchange, cancellation with compensation) of terminating the rights and obligations under forward contracts to buy or sell foreign currency?

4. Should the source of a foreign exchange gain or loss be determined on a transaction-by-transaction basis? If source should be determined by reference to an underlying or related transaction, what rules should be used to identify such transactions? Should foreign exchange gains or losses on part or all of a taxpayer's transactions be

combined, and the net gain or loss attributed entirely to either domestic source or foreign source? Apportioned between the two? What would be the basis of such an apportionment?

II. Taxpayer Keeping Accounts in Foreign Currency

A. Branches. Does a profit-and-loss method or a net-worth method (see Example 2 below) ordinarily result in a more accurate measure of the taxable income of a foreign branch which transacts its business and keeps its accounts in a foreign currency?

1. If one method is more accurate than the other, are there nonetheless reasons why a taxpayer should be able to elect either method?

2. Are the rules promulgated in Revenue Rulings 75-106 and 75-107 satisfactory in implementing a net-worth and a profit-and-loss method, respectively? If not, what changes should be made?

B. Subsidiaries. How should the earnings and profits and section 902 accumulated profits in excess of foreign taxes be computed for a foreign subsidiary which keeps its accounts and transacts its business in a foreign currency?

1. Should a foreign corporation's earnings and profits and section 902 accumulated profits in excess of foreign taxes invariably include foreign exchange gain or loss? If not, when should such gain or loss be excluded? If such gain or loss is to be included, would the regulations issued under section 964 provide a satisfactory method of computing such gain or loss? If not, what changes in those regulations would be desirable?

2. Should earnings and profits for purposes of section 951-964 (Subpart F) invariably be computed under the same rules as are used in calculating dividend income? If not, when and how should the rules differ?

C. Transactions in Dollars or Third-Country Currencies. If a foreign branch or subsidiary keeps its accounts in a foreign currency, what rules should determine the recognition, character, and source of the gain or loss

on transactions involving dollars? Should those same rules apply to transactions in third-country currencies?

III. Amount of Foreign Income Tax

A. Payment vs. Accrual. If a foreign exchange rate fluctuates between the accrual and the payment of a foreign income tax liability denominated in a foreign currency, how should the amount of foreign tax credit be calculated? Should the amount of taxable income or accumulated profits reflect the adjustment in the amount of tax?

B. "Deemed Paid" Credit. What exchange rates should be used in translating the numerator, denominator, and multiplicand in calculating the "deemed paid" credit under section 902? Under section 960?

IV. Special Treatment of Certain Groups of Taxpayers. Should uniform rules apply to all taxpayers? Or do certain groups merit special treatment?

A. Should the rules applied to other taxpayers for calculating taxable income and income taxes paid apply to individuals as well?

B. Do any industries (e.g., banking, insurance) merit special treatment not applicable to other taxpayers? If so, how should the industries be defined? What special rules are required?

Examples

The following hypothetical examples are intended to illustrate some conceptual issues raised by fluctuations in the value of foreign exchange against the U.S. dollar. Each, of course, could be reformulated to yield different numerical results. Commentators may wish to modify these examples or to develop others to illustrate additional issues.

Example 1

Suppose a U.S. lender has $300. $100 is lent to a U.S. borrower for one year at 10 percent per annum. $100 is converted into Swiss francs and lent to a Swiss borrower for

one year at 3 percent per annum; $100 is converted into Spanish pesetas and lent to a Spanish borrower for one year at 20 percent per annum. The lender does not hedge either foreign currency loan. Each loan and the interest thereon is to be repaid in foreign currency.

At the end of one year, interest and principal on all three loans are paid. Because of foreign exchange fluctuations, the lender's economic gain is as follows:

Currency of loan	Appreciation [or depreciation] of currency during year against dollar	Interest plus foreign exchange gain on interest as percent of original principal	Foreign exchange gain [or loss] on original principal as percent of original principal	Total gain as percent of original principal
Dollar	No change	10%	0%	10%
Swiss franc	+15%	3% + .45%	15%	18.45%
Spanish peseta	-15%	20% - 3%	-15%	2%

How much income should the taxpayer recognize? What is its character and source?

Suppose the lender at the beginning of the year had hedged the foreign currency exposure by entering forward exchange contracts to sell the anticipated foreign currency proceeds from the repayment of interest and principal at the end of the year. Because of "covered interest rate arbitrage," the forward exchange rate at the beginning of the year for Swiss francs to be delivered at the end of the year might have been 6.8 percent higher than the spot rate at the beginning of the year, whereas the forward rate for Spanish pesetas might have been 8.3 percent lower than the spot rate at the beginning of the year. This forward premium on Swiss francs and forward discount on Spanish pesetas would assure that the net rate of return (i.e., interest plus foreign exchange gain or loss on repayment of principal plus the gain or loss on the forward exchange contract) on each

foreign currency loan would be 10 percent per annum, the same as the interest rate on dollars. What should be the tax consequences of such covered lending?

Example 2

On December 31, 1978, a U.S. corporation advances to the account of a foreign branch or subsidiary 500 francs, which were purchased on that date for $100 (i.e., the exchange rate was $.20/franc). In 1979, the branch or subsidiary engages in the following transactions:

Date	Exchange Rate	Event
3/30/79	$.21/f	Purchase inventory for 500 francs
6/30/79	$.22/f	Sell inventory for 600 francs
9/30/79	$.23/f	Convert 30 francs into $6.90 and remit to head office or parent corporation
12/31/79	$.24/f	Year ends

Under a "separate transactions" method, the taxpayer might recognize for tax purposes a foreign exchange gain of $5 when the 500 francs in which it had a basis of $100 were exchanged for inventory worth $105. The sale of the inventory would yield net gain of $27, the difference between the 600 francs received, which at $.22/franc are worth $132, and the basis in the inventory, $105. (This $27 can be thought of as including a $22 profit obtained by translating the 100 franc profit at $.22/franc, plus a $5 foreign exchange gain attributable to the appreciation in the franc while the inventory was held.) Finally, the taxpayer would recognize a $.30 foreign exchange gain on the sale for $6.90 of the 30 francs in which it had a basis of $6.60. At the end of the year, the taxpayer would have total gains of $32.30 ($5 plus $22 plus $5 plus $.30). The taxpayer would also have an unrealized foreign exchange gain of $11.40, which is equal to the 570 francs on hand at the end of the year multiplied by the $.02/franc appreciation in the value of the franc between the time the francs were obtained from the sale of inventory and the end of the year.

Under a "profit-and-loss" method, taxable income might be determined by translating the 30 francs which were remitted to the head office at $.23/franc, which equals $6.90, and the remaining 70 francs of profit at the year-end rate of $.24/franc, which equals $16.80. Total gains would equal $23.70, which differs from gains under the separate transactions analysis by $8.60. This $8.60, in turn, equals the difference between (1) the $10.00 in foreign exchange gain recognized under the separate transactions analysis -- $5 on the purchase and $5 on the sale of the inventory -- and (2) the $1.40 of unrealized foreign exchange gain taken into account under the profit-and-loss method by translating the 70 francs in unremitted income at the year-end rate, $.24/franc, rather than at the rate on the date it was earned, $.22/franc (i.e., 70 francs at $.02/franc equals $1.40).

Under a "net worth" method, the balance sheet would first be translated into dollars. Assuming the 570 francs on hand at the end of the year were invested in current assets (e.g., a bank account), they would be translated at the year-end rate, $.24/franc. The year-end value of total assets and therefore, in this example, net worth would be $136.80, an increase of $36.80 over the dollar value of net worth at the end of the previous year. This $36.80 plus the $6.90 in remitted income yields total gain of $43.70. This exceeds gain calculated under the separate transactions analysis, $32.30, by $11.40, the amount of unrealized gain on current assets attributable to the appreciation in the franc between the time the current assets were acquired and the end of the year.

Example 3

Suppose that a wholly owned foreign subsidiary established in 1977 with no initial capital recorded the following profits and foreign taxes paid:

Year	Exchange Rate	Current Profits Before Taxes	Foreign Taxes Paid	Cumulative Year-End Foreign Subsidiary Profits After Taxes
1977	$.20/franc	100 francs	40 francs	60 francs
1978	$.25/franc	100 francs	40 francs	120 francs
1979	$.40/franc	0 francs	0 francs	120 francs

On December 31, 1979, the foreign corporation distributes 100 francs, which have a fair market value of $.40/franc, or $40. How should the amount of the dividend, the section 902 credit, and the reduction in earnings and profits be computed?

One possibility would be to translate earnings and profits, accumulated profits in excess of foreign taxes, and foreign taxes paid at the exchange rate on the date of distribution, $.40/franc. Under that procedure, the following results would obtain:

-- The distribution would be considered a dividend in full because its value, $40, is less than the current value of all earnings and profits, $48 (i.e., (60f x $.40/f) + (60f x f.40/f). After the distribution, 20 francs would remain in the earnings and profits account; if subsequent distributions are made, the dollar value of remaining earnings and profits would be determined by translating the 20 francs at the exchange rate on the date of such distributions.

-- The section 902 deemed paid credit would be determined as follows:

1978

$$\frac{60f \times \$.40/f}{60f \times \$.40/f} \; [40f \times \$.40/f]$$

1977

$$+ \; \frac{40f \times \$.40/f}{60f \times \$.40/f} \; [40f \times \$.40/f] \quad = \quad \$26.67$$

A second alternative would be to translate dividend income and the dividend numerator of the deemed-paid credit fraction at the current exchange rate, to translate earnings and profits, accumulated profits in excess of foreign taxes, and taxes paid in prior years at their historical exchange rates, and to calculate earnings and profits and accumulated profits in excess of foreign taxes under a profit-and-loss method, rather than a net-worth method. Under this alternative, the following results would obtain:

-- Earnings and profits equal \$27 (i.e., (60f x \$.25/f) + (60f x \$.20/f)), so only that amount would be considered a dividend. The remaining \$13 of the \$40 distributed would be capital gain on the shares in the subsidiary (or, on other facts, a return of capital).

-- The "deemed paid" credit would equal:

1978

$$\frac{\$15}{60f \times \$.25/f} \; [40f \times \$.25/f]$$

1977

$$+ \; \frac{\$12}{60f \times \$.20/f} \; [40f \times \$.20/f] \; = \; \$18$$

If the same exchange rates as above were used for translating the components of the deemed paid credit formula, but earnings and profits and accumulated profits were computed under a net worth method, then:

-- Earnings and profits would equal \$48 (in addition to the \$27 computed above, the corporation would have, if it invested its profits in current assets, a foreign exchange gain of \$3 in 1978 and \$18 in 1979). Accordingly, the \$40 distribution would be considered a dividend in full.

-- The "deemed paid" credit, would equal:

1979   1978

$$\frac{\$18}{\$18} \; \$0 \; + \; \frac{\$18}{(60f \times \$.25/f) + \$3} \; [40f \times \$.25/f]$$

1977

$$+ \; \frac{\$4}{60f \times \$.20/f} \; [40f \times \$.20/f] \; = \; \$12.67$$

partment of the TREASURY NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041

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Contact: George G. Ross
202/566-2356

TREASURY SEEKS PUBLIC COMMENT
ON TAX TREATMENT OF FOREIGN
EXCHANGE GAINS AND LOSSES

The Treasury Department today issued a series of questions about the appropriate tax treatment of foreign exchange gains and losses. In so doing, the Treasury is expressing no position as to the state of existing law. Instead, the Treasury is requesting public comment to determine whether clarification or modification is needed and, if so, the nature of such clarification or modification.

Persons interested in offering comments on the issues raised in the attached paper are invited to send their comments in writing to H. David Rosenbloom, International Tax Counsel, U.S. Department of the Treasury, Room 3064, Main Treasury Building, Washington, D.C. 20220.

Written comments should be received by August 31, 1980, in order to be sure that they will be taken into account in the formulation of any proposal.

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M-422

ISSUES RELATED TO THE APPROPRIATE TAX TREATMENT OF FOREIGN EXCHANGE GAINS AND LOSSES

The Treasury Department is considering the appropriate tax treatment of gains and losses attributable to foreign exchange rate fluctuations. As an aid to determining whether proposals are desirable in this area, the Treasury would appreciate receiving comments on the issues and examples listed below as well as any other related issues which require attention. In raising these issues, the Treasury is not expressing any position as to their resolution under existing law.

I. Taxpayers Normally Keeping Accounts in Dollars

A. Recognition. When should a taxpayer who normally transacts business and keeps accounts in dollars recognize foreign exchange gain or loss?

1. Should such a taxpayer who lends foreign currency recognize gain or loss upon repayment of the loan? Or should recognition await sale or exchange of the foreign currency proceeds for dollars, another currency or other property?

2. Should such a taxpayer borrowing foreign currency recognize gain or loss on repayment of a loan? Should a taxpayer be able to defer recognition of such a gain by reducing its basis in appropriate assets?

3. If a taxpayer contracts to purchase foreign currency under a forward exchange contract at a specified exchange rate and subsequently takes delivery of the foreign exchange under the terms of that contract, should a gain or loss be recognized upon the purchase? If not, upon what dispositions or uses of the foreign currency should gain or loss be recognized?

B. Character. Should foreign exchange gains and losses be ordinary or should they be capital? To what extent should present Internal Revenue Code rules designed to deal with special securities and commodity transactions (e.g., short sales, holding periods, options) apply to foreign currency?

1. If a U.S. taxpayer hedges the foreign currency exposure of a foreign subsidiary through a forward exchange contract, should gain or loss attributable to the contract be ordinary or should it be capital? Should the character of the gain or loss depend on whether the contract is performed, sold or exchanged, or cancelled with compensation?

2. If a creditor recognizes foreign exchange gain or loss on repayment of a foreign currency loan, what rules should determine the character of the gain or loss? Should the gain or loss be treated as an adjustment of interest income?

3. If a borrower recognizes foreign exchange gain or loss on repayment of a foreign currency loan, what rules should determine the character of the gain or loss? Should the gain or loss be treated as an adjustment of interest expense? As gain or loss on a short sale?

C. Source. Should foreign exchange gains and losses be domestic source or should they be foreign source?

1. If foreign exchange gain is recognized by a creditor on repayment of a foreign currency loan, what rules should determine the source of such gain? If a loss is recognized, how should that loss be allocated or apportioned?

2. How should analogous gains and losses of a borrower on repayment of a foreign currency loan be sourced?

3. What source rules should determine the source of gain or loss recognized under alternative methods (e.g., performance, sale or exchange, cancellation with compensation) of terminating the rights and obligations under forward contracts to buy or sell foreign currency?

4. Should the source of a foreign exchange gain or loss be determined on a transaction-by-transaction basis? If source should be determined by reference to an underlying or related transaction, what rules should be used to identify such transactions? Should foreign exchange gains or losses on part or all of a taxpayer's transactions be

combined, and the net gain or loss attributed entirely to either domestic source or foreign source? Apportioned between the two? What would be the basis of such an apportionment?

II. Taxpayer Keeping Accounts in Foreign Currency

A. Branches. Does a profit-and-loss method or a net-worth method (see Example 2 below) ordinarily result in a more accurate measure of the taxable income of a foreign branch which transacts its business and keeps its accounts in a foreign currency?

1. If one method is more accurate than the other, are there nonetheless reasons why a taxpayer should be able to elect either method?

2. Are the rules promulgated in Revenue Rulings 75-106 and 75-107 satisfactory in implementing a net-worth and a profit-and-loss method, respectively? If not, what changes should be made?

B. Subsidiaries. How should the earnings and profits and section 902 accumulated profits in excess of foreign taxes be computed for a foreign subsidiary which keeps its accounts and transacts its business in a foreign currency?

1. Should a foreign corporation's earnings and profits and section 902 accumulated profits in excess of foreign taxes invariably include foreign exchange gain or loss? If not, when should such gain or loss be excluded? If such gain or loss is to be included, would the regulations issued under section 964 provide a satisfactory method of computing such gain or loss? If not, what changes in those regulations would be desirable?

2. Should earnings and profits for purposes of section 951-964 (Subpart F) invariably be computed under the same rules as are used in calculating dividend income? If not, when and how should the rules differ?

C. Transactions in Dollars or Third-Country Currencies. If a foreign branch or subsidiary keeps its accounts in a foreign currency, what rules should determine the recognition, character, and source of the gain or loss

on transactions involving dollars? Should those same rules apply to transactions in third-country currencies?

III. Amount of Foreign Income Tax

A. Payment vs. Accrual. If a foreign exchange rate fluctuates between the accrual and the payment of a foreign income tax liability denominated in a foreign currency, how should the amount of foreign tax credit be calculated? Should the amount of taxable income or accumulated profits reflect the adjustment in the amount of tax?

B. "Deemed Paid" Credit. What exchange rates should be used in translating the numerator, denominator, and multiplicand in calculating the "deemed paid" credit under section 902? Under section 960?

IV. Special Treatment of Certain Groups of Taxpayers. Should uniform rules apply to all taxpayers? Or do certain groups merit special treatment?

A. Should the rules applied to other taxpayers for calculating taxable income and income taxes paid apply to individuals as well?

B. Do any industries (e.g., banking, insurance) merit special treatment not applicable to other taxpayers? If so, how should the industries be defined? What special rules are required?

Examples

The following hypothetical examples are intended to illustrate some conceptual issues raised by fluctuations in the value of foreign exchange against the U.S. dollar. Each, of course, could be reformulated to yield different numerical results. Commentators may wish to modify these examples or to develop others to illustrate additional issues.

Example 1

Suppose a U.S. lender has $300. $100 is lent to a U.S. borrower for one year at 10 percent per annum. $100 is converted into Swiss francs and lent to a Swiss borrower for

one year at 3 percent per annum; $100 is converted into Spanish pesetas and lent to a Spanish borrower for one year at 20 percent per annum. The lender does not hedge either foreign currency loan. Each loan and the interest thereon is to be repaid in foreign currency.

At the end of one year, interest and principal on all three loans are paid. Because of foreign exchange fluctuations, the lender's economic gain is as follows:

Currency of loan	Appreciation [or depreciation] of currency during year against dollar	Interest plus foreign exchange gain on interest as percent of original principal	Foreign exchange gain [or loss] on original principal as percent of original principal	Total gain as percent of original principal
Dollar	No change	10%	0%	10%
Swiss franc	+15%	3% + .45%	15%	18.45%
Spanish peseta	-15%	20% - 3%	-15%	2%

How much income should the taxpayer recognize? What is its character and source?

Suppose the lender at the beginning of the year had hedged the foreign currency exposure by entering forward exchange contracts to sell the anticipated foreign currency proceeds from the repayment of interest and principal at the end of the year. Because of "covered interest rate arbitrage," the forward exchange rate at the beginning of the year for Swiss francs to be delivered at the end of the year might have been 6.8 percent higher than the spot rate at the beginning of the year, whereas the forward rate for Spanish pesetas might have been 8.3 percent lower than the spot rate at the beginning of the year. This forward premium on Swiss francs and forward discount on Spanish pesetas would assure that the net rate of return (i.e., interest plus foreign exchange gain or loss on repayment of principal plus the gain or loss on the forward exchange contract) on each

foreign currency loan would be 10 percent per annum, the same as the interest rate on dollars. What should be the tax consequences of such covered lending?

Example 2

On December 31, 1978, a U.S. corporation advances to the account of a foreign branch or subsidiary 500 francs, which were purchased on that date for $100 (i.e., the exchange rate was $.20/franc). In 1979, the branch or subsidiary engages in the following transactions:

Date	Exchange Rate	Event
3/30/79	$.21/f	Purchase inventory for 500 francs
6/30/79	$.22/f	Sell inventory for 600 francs
9/30/79	$.23/f	Convert 30 francs into $6.90 and remit to head office or parent corporation
12/31/79	$.24/f	Year ends

Under a "separate transactions" method, the taxpayer might recognize for tax purposes a foreign exchange gain of $5 when the 500 francs in which it had a basis of $100 were exchanged for inventory worth $105. The sale of the inventory would yield net gain of $27, the difference between the 600 francs received, which at $.22/franc are worth $132, and the basis in the inventory, $105. (This $27 can be thought of as including a $22 profit obtained by translating the 100 franc profit at $.22/franc, plus a $5 foreign exchange gain attributable to the appreciation in the franc while the inventory was held.) Finally, the taxpayer would recognize a $.30 foreign exchange gain on the sale for $6.90 of the 30 francs in which it had a basis of $6.60. At the end of the year, the taxpayer would have total gains of $32.30 ($5 plus $22 plus $5 plus $.30). The taxpayer would also have an unrealized foreign exchange gain of $11.40, which is equal to the 570 francs on hand at the end of the year multiplied by the $.02/franc appreciation in the value of the franc between the time the francs were obtained from the sale of inventory and the end of the year.

Under a "profit-and-loss" method, taxable income might be determined by translating the 30 francs which were remitted to the head office at $.23/franc, which equals $6.90, and the remaining 70 francs of profit at the year-end rate of $.24/franc, which equals $16.80. Total gains would equal $23.70, which differs from gains under the separate transactions analysis by $8.60. This $8.60, in turn, equals the difference between (1) the $10.00 in foreign exchange gain recognized under the separate transactions analysis -- $5 on the purchase and $5 on the sale of the inventory -- and (2) the $1.40 of unrealized foreign exchange gain taken into account under the profit-and-loss method by translating the 70 francs in unremitted income at the year-end rate, $.24/franc, rather than at the rate on the date it was earned, $.22/franc (i.e., 70 francs at $.02/franc equals $1.40).

Under a "net worth" method, the balance sheet would first be translated into dollars. Assuming the 570 francs on hand at the end of the year were invested in current assets (e.g., a bank account), they would be translated at the year-end rate, $.24/franc. The year-end value of total assets and therefore, in this example, net worth would be $136.80, an increase of $36.80 over the dollar value of net worth at the end of the previous year. This $36.80 plus the $6.90 in remitted income yields total gain of $43.70. This exceeds gain calculated under the separate transactions analysis, $32.30, by $11.40, the amount of unrealized gain on current assets attributable to the appreciation in the franc between the time the current assets were acquired and the end of the year.

Example 3

Suppose that a wholly owned foreign subsidiary established in 1977 with no initial capital recorded the following profits and foreign taxes paid:

Year	Exchange Rate	Current Profits Before Taxes	Foreign Taxes Paid	Cumulative Year-End Foreign Subsidiary Profits After Taxes
1977	$.20/franc	100 francs	40 francs	60 francs
1978	$.25/franc	100 francs	40 francs	120 francs
1979	$.40/franc	0 francs	0 francs	120 francs

On December 31, 1979, the foreign corporation distributes 100 francs, which have a fair market value of $.40/franc, or $40. How should the amount of the dividend, the section 902 credit, and the reduction in earnings and profits be computed?

One possibility would be to translate earnings and profits, accumulated profits in excess of foreign taxes, and foreign taxes paid at the exchange rate on the date of distribution, $.40/franc. Under that procedure, the following results would obtain:

-- The distribution would be considered a dividend in full because its value, $40, is less than the current value of all earnings and profits, $48 (i.e., (60f x $.40/f) + (60f x f.40/f). After the distribution, 20 francs would remain in the earnings and profits account; if subsequent distributions are made, the dollar value of remaining earnings and profits would be determined by translating the 20 francs at the exchange rate on the date of such distributions.

-- The section 902 deemed paid credit would be determined as follows:

<u>1978</u>

$$\frac{60f \times \$.40/f}{60f \times \$.40/f} \; [40f \times \$.40/f]$$

<u>1977</u>

$$+ \; \frac{40f \times \$.40/f}{60f \times \$.40/f} \; [40f \times \$.40/f] \; = \; \$26.67$$

A second alternative would be to translate dividend income and the dividend numerator of the deemed-paid credit fraction at the current exchange rate, to translate earnings and profits, accumulated profits in excess of foreign taxes, and taxes paid in prior years at their historical exchange rates, and to calculate earnings and profits and accumulated profits in excess of foreign taxes under a profit-and-loss method, rather than a net-worth method. Under this alternative, the following results would obtain:

-- Earnings and profits equal \$27 (i.e., (60f x \$.25/f) + (60f x \$.20/f)), so only that amount would be considered a dividend. The remaining \$13 of the \$40 distributed would be capital gain on the shares in the subsidiary (or, on other facts, a return of capital).

-- The "deemed paid" credit would equal:

<u>1978</u>

$$\frac{\$15}{60f \times \$.25/f} \quad [40f \times \$.25/f]$$

<u>1977</u>

$$+ \frac{\$12}{60f \times \$.20/f} \quad [40f \times \$.20/f] \quad = \quad \$18$$

If the same exchange rates as above were used for translating the components of the deemed paid credit formula, but earnings and profits and accumulated profits were computed under a net worth method, then:

-- Earnings and profits would equal \$48 (in addition to the \$27 computed above, the corporation would have, if it invested its profits in current assets, a foreign exchange gain of \$3 in 1978 and \$18 in 1979). Accordingly, the \$40 distribution would be considered a dividend in full.

-- The "deemed paid" credit, would equal:

<u>1979</u> <u>1978</u>

$$\frac{\$18}{\$18} \ \$0 \quad + \quad \frac{\$18}{(60f \times \$.25/f) + \$3} \quad [40f \times \$.25/f]$$

<u>1977</u>

$$+ \quad \frac{\$4}{60f \times \$.20/f} \quad [40f \times \$.20/f] \quad = \quad \$12.67$$

Finally, if dividend income were translated at the current exchange rate, foreign income taxes were translated at historical rates, and the dividend numerator, the accumulated-profits-in-excess-of-foreign-taxes denominator, and earnings and profits were simply not translated into dollars, then:

-- The 100 franc distribution would be a dividend in full because it is less than the 120 francs of earnings and profits, and

-- The "deemed paid" credit would be:

$$\underbrace{\frac{60f}{60f}\,[40f \times \$.25/f]}_{1978} + \underbrace{\frac{40f}{60f}\,[40f \times \$.20/f]}_{1977} = \$16.67$$

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FOR IMMEDIATE RELEASE April 10, 1980

TREASURY SECRETARY MILLER NAMES FRANK G. TURPIN
SAVINGS BONDS CHAIRMAN FOR ALASKA

Frank G. Turpin, President, Alyeska Pipeline Service Company, has been appointed Volunteer Alaska State Chairman for the Savings Bonds Program by Secretary of the Treasury G. William Miller.

He succeeds Ben W. Agee, former President, RCA Communications, Inc.

Mr. Turpin will head a committee of business, financial, labor, media, and governmental leaders, who -- in cooperation with the U.S. Savings Bonds Division -- will assist in promoting the sale of Savings Bonds.

Mr. Turpin received his B.S. and M.S. degrees in Chemical Engineering from Virginia Polytechnic Institute. Prior to joining Alyeska Pipeline in 1978, Mr. Turpin had an extensive career with Exxon. He began as an engineer, research laboratories, Baton Rouge, La. in 1947, and moved into various management assignments with the company. In 1966 he left Exxon and worked as Administrative Manager for Baytown

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Refinery, Tx., and in 1968 he became Refinery Manager. He returned to Exxon, U.S.A. in 1970 as Manager, Long Range Planning for the Refining Department in Houston, Tx., and in 1971 he was appointed Vice President, Engineering, Exxon Research and Engineering Company, Florham Park, N.J. He was appointed Vice President, Petroleum Research, in 1974 and joined Alyeska Pipeline Service Company in 1978.

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ederal financing bank NEWS
WASHINGTON, D.C. 20220
Press inquiries: 202-566-2615

FOR IMMEDIATE RELEASE April 10, 1980

FEDERAL FINANCING BANK ACTIVITY

Roland H. Cook, Secretary, Federal Financing Bank (FFB), announced the following activity for February 1-29, 1980.

Guarantee Programs

During February, FFB made 19 advances totalling $71,052,565.51 to 14 governments under loan agreements guaranteed by the Department of Defense pursuant to the Arms Export Control Act.

Under notes guaranteed by the Rural Electrification Administration, FFB advanced a total of $173,495,771.25 to 26 rural electric and telephone cooperatives.

On February 20, FFB purchased a total of $9,250,000.00 in debentures issued by 9 small business investment companies. These debentures are guaranteed by the Small Business Administration, mature in 3, 5 and 10 years, and carry interest rates of 12.615%, 12.435% and 12.375%, respectively.

On February 29, FFB signed Note #5 with Seven States Energy Corporation under a $2 billion nuclear fuel lease agreement. Note #5 is in the amount of $15,741,592.43, matures May 31, 1980, and carries an interest rate of 14.542%.

FFB provided Western Union Space Communications, Inc., with $7,450,000 on February 1, and $4,125,000 on February 20. Both advances mature October 1, 1989, and carry interest rates of 11.654% and 13.607%, respectively, on an annual basis.

During February, FFB purchased the following General Services Administration public buildings interim certificates:

Date	Series	Amount	Maturity	Interest Rate
2/8	M-057	$2,956,275.27	7/31/03	12.080%
2/14	L-064	315,391.88	11/15/04	12.177%
2/29	K-030	247,832.26	7/15/04	13.106%

On February 24, FFB lent $1.7 million to the City of Mayaguez, Puerto Rico, under the Department of Housing and Urban Development-guaranteed Block Grant program. This loan matures August 1, 1980, and carries an interest rate of 13.375%.

M-424

Department of Transportation Guarantees

Under notes guaranteed by the Department of Transportation pursuant to Section 511 of the Railroad Revitalization and Regulatory Reform Act of 1976, FFB lent funds to the following railroads:

	Date	Amount	Maturity	Interest Rate
Missouri-Kansas-Texas RR	2/8	$ 650,000.00	11/15/96	11.787% qtr.
Chicago, North Western 511-78-3	2/11	1,427,924.00	11/1/90	12.002%
Missouri-Kansas-Texas RR	2/28	250,000.00	11/15/96	13.240% qtr

On February 25, FFB lent The Milwaukee Road $8,574,254 at an interest rate of 14.445%. The advance matures July 3, 1980. This advance is the last installment of the $30 million Trustee Certificate issued by The Milwaukee Road on January 3, 1980, and guaranteed by the Department of Transportation pursuant to the Emergency Rail Services Act, as amended.

On February 29, Amtrak borrowed $5 million under their Note #21, which matures March 31, 1980. The funds were advanced at a rate of 14.362%.

Agency Issuers

During February, the Student Loan Marketing Association, a federally chartered private corporation, increased its notes outstanding with FFB by $125 million.

On February 25, FFB purchased a $920 million Certificate of Beneficial Ownership from the Farmers Home Administration. This certificate matures February 25, 1985, and carries an interest rate of 14.014%, payable annually.

During February, the National Credit Union Administration's Central Liquidity Facility issued the following notes to FFB:

Date	Note #	Amount	Maturity	Interest Rate
2/7	11	$ 3,381,000.00	5/7/80	12.847%
2/14	12	10,750,000.00	5/14/80	12.966%
2/27	13	4,350,605.00	5/28/80	14.629%

Also during February, the Tennessee Valley Authority sold FFB the following notes maturing May 30, 1980.

Date	Note #	Amount	Interest Rate
2/8	124	$ 70,000,000	12.864%
2/18	125	10,000,000	13.375%
2/28	126	20,000,000	14.575%
2/29	127	305,000,000	14.542%

FFB Holdings

As of February 29, 1980, FFB holdings totalled $69.3 billion. FFB Holdings and Activity Tables are attached.

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FEDERAL FINANCING BANK HOLDINGS
(in millions of dollars)

Program	February 29, 1980	January 31, 1980	Net Change (2/1/80-2/29/80)	Net Change-FY 80 (10/1/79-2/29/80)
On-Budget Agency Debt				
Tennessee Valley Authority	$ 7,622.0	$ 7,457.0	$165.0	$ 497.0
Export-Import Bank	8,352.7	8,352.7	-0-	399.8
NCUA-Central Liquidity Facility	18.5	31.6	-13.1	18.5
Off-Budget Agency Debt				
U.S. Postal Service	1,587.0	1,587.0	-0-	-0-
U.S. Railway Association	440.5	440.5	-0-	-5.2
Agency Assets				
Farmers Home Administration	32,565.0	32,145.0	420.0	1,485.0
DHEW-Health Maintenance Org. Loans	85.5	94.1	-8.6	8.2
DHEW-Medical Facilities Loans	160.1	160.1	-0-	-0-
Overseas Private Investment Corp.	33.6	33.6	-0-	-2.2
Rural Electrification Admin.-CBO	1,223.2	1,223.2	-0-	-0-
Small Business Administration	88.0	89.2	-1.2	-6.4
Government Guaranteed Loans				
DOT-Emergency Rail Services Act	72.0	63.4	8.6	34.6
DOT-Title V, RRRR Act	110.4	108.1	2.3	17.7
DOD-Foreign Military Sales	5,826.2	5,762.7	63.5	555.3
General Services Administration	383.4	379.9	3.5	23.7
Guam Power Authority	36.0	36.0	-0-	-0-
DHUD-New Communities Admin.	33.5	33.5	-0-	-5.0
DHUD-Community Block Grant	9.1	7.4	1.7	3.7
Nat'l. Railroad Passenger Corp. (AMTRAK)	410.6	405.6	5.0	-21.7
Western Union Space Comm. (NASA)	476.1	464.6	11.6	55.8
Rural Electrification Administration	6,874.0	6,700.5	173.5	947.6
Seven States Energy Corp. (TVA)	569.3	562.2	7.1	569.3
Small Business Investment Companies	372.4	363.2	9.3	36.1
Student Loan Marketing Association	1,720.0	1,595.0	125.0	445.0
Virgin Islands	21.3	21.3	-0-	-0.2
WMATA	177.0	177.0	-0-	-0-
TOTALS	$69,267.5*	$68,294.4	$973.0*	$5,056.4*

Federal Financing Bank April 9, 1980

*Totals do not add due to rounding.

FEDERAL FINANCING BANK

February 1980 Activity

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
DEPARTMENT OF DEFENSE					
Greece #10	2/5	$ 80,464.00	2/1/89	11.652%	
Thailand #3	2/6	124,961.00	9/20/84	12.283%	
Ecuador #3	2/13	10,506.00	8/1/85	12.285%	
Korea #10	2/13	125,000.00	12/31/87	12.188%	
Taiwan #9	2/13	976,500.00	7/1/86	12.241%	
Tunisia #6	2/13	16,080.00	5/5/87	12.222%	
Israel #9	2/14	34,162,167.77	12/15/09	12.054%	
Colombia #3	2/15	99,237.37	9/20/85	12.292%	
Korea #10	2/15	9,279,847.34	12/31/87	12.197%	
Peru #5	2/15	1,500,000.00	3/15/86	12.215%	
Liberia #4	2/19	2,041.38	10/30/84	12.750%	
Spain #1	2/20	68.20	6/10/87	13.316%	
Korea #10	2/20	82,773.00	12/31/87	13.258%	
Turkey #2	2/21	2,041,523.04	10/1/86	13.484%	
Turkey #4	2/21	3,873,009.62	10/1/87	13.406%	
Colombia #3	2/25	583,701.50	9/20/85	13.913%	
Jordan #3	2/25	119,120.40	12/31/86	13.783%	
Thailand #6	2/25	95,357.00	9/20/85	13.913%	
Israel #9	2/27	17,880,207.89	12/15/09	13.240%	
FARMERS HOME ADMINISTRATION					
Certificate of Beneficial Ownership	2/25	920,000,000.00	2/25/85	13.555%	14.014% annually
GENERAL SERVICES ADMINISTRATION					
Series M-057	2/8	2,956,275.27	7/31/03	12.080%	
Series L-064	2/14	315,391.88	11/15/04	12.177%	
Series K-030	2/19	247,832.26	7/15/04	13.106%	
DEPARTMENT OF HEALTH, EDUCATION & WELFARE					
Mayaguez, Puerto Rico	2/14	1,700,000.00	8/1/80	13.375%	
NATIONAL CREDIT UNION ADMINISTRATION					
Note #11	2/7	3,381,000.00	5/7/80	12.847%	
Note #12	2/14	10,750,000.00	5/14/80	12.966%	
Note #13	2/27	4,350,605.00	5/28/80	14.629%	
RURAL ELECTRIFICATION ADMINISTRATION					
Arkansas Electric	2/4	5,088,000.00	2/4/82	12.215%	12.034% quarterly
Arkansas Electric #142	2/4	27,221,000.00	2/4/82	12.215%	12.034% "
Alabama Electric #26	2/4	7,600,000.00	2/4/82	12.215%	12.034% "
Western Farmers Electric #64	2/4	6,000.00	2/4/83	11.555%	11.393% "
Western Farmers Electric #126	2/4	1,222,000.00	2/4/83	11.555%	11.393% "
Western Farmers Electric #133	2/4	15,572,000.00	2/4/83	11.555%	11.393% "
Central Electric Power #131	2/4	50,000.00	2/4/87	11.465%	11.305% "
San Miguel Electric #110	2/5	9,005,000.00	1/25/83	11.735%	11.568% "
Brazos Electric Power #144	2/7	962,353.25	2/7/82	12.595%	12.403% "
Ponderosa Telephone #35	2/7	302,000.00	12/31/14	11.996%	11.821% "
Chugach Electric #82	2/7	3,447,000.00	12/31/14	11.996%	11.821% "
Western Illinois Power #99	2/8	1,954,000.00	2/8/82	12.385%	12.199% "
Orange City Telephone #10	2/8	1,235,000.00	12/31/14	11.896%	11.724% "

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
RURAL ELECTRIFICATION ADMINISTRATION (cont.)					
Wabash Valley Power #104	2/8	$ 2,482,000.00	12/31/14	11.896%	11.724% quarterl
Tri-State Gen. & Trans. #37	2/11	16,000.00	1/31/87	12.035%	11.859% "
Wolverine Electric #100	2/11	510,000.00	2/11/82	12.485%	11.296% "
Allegheny Electric #93	2/11	3,622,000.00	2/28/82	12.435%	12.247% "
Northern Michigan Electric #101	2/11	653,000.00	2/11/83	11.995%	11.820% "
Chugach Electric #82	2/11	7,250,000.00	12/31/14	11.912%	11.740% "
South Texas Electric #109	2/13	2,000,000.00	2/13/82	12.775%	12.577% "
Colorado Ute Electric #78	2/13	776,000.00	2/13/82	12.775%	12.577% "
Colorado Ute Electric #78	2/15	2,779,000.00	2/15/82	12.775%	12.577% "
Big Rivers Electric #58	2/20	20,000.00	2/20/82	14.135%	13.894% "
Big Rivers Electric #65	2/20	138,000.00	2/20/82	14.135%	13.894% "
Big Rivers Electric #91	2/20	4,883,000.00	2/20/82	14.135%	13.894% "
Big Rivers Electric #136	2/20	560,000.00	2/20/82	14.135%	13.894% "
Doniphan Telephone #14	2/21	87,418.00	12/31/14	12.785%	12.587% "
Central Electric Power #131	2/25	50,000.00	2/25/87	13.505%	13.284% "
South Mississippi Electric #90	2/26	709,000.00	3/1/82	14.795%	14.531% "
United Power #86	2/27	600,000.00	2/27/82	15.085%	14.811% "
Continental Tel. of the South#106	2/27	6,000,000.00	12/31/14	13.081%	12.874% "
Continental Tel. of the South#134	2/27	1,300,000.00	12/31/14	13.081%	12.874% "
Gulf Telephone #50	2/28	552,000.00	12/31/14	12.982%	12.778% "
Basin Electric #87	2/29	30,000,000.00	3/1/82	14.585%	14.328% "
Basin Electric #87	2/29	282,000.00	3/1/82	14.585%	14.328% "
Buckeye Power #153	2/29	15,906,000.00	3/1/82	14.585%	14.328% "
Arkansas Electric #97	2/29	9,612,000.00	3/1/82	14.585%	14.328% "
Southern Illinois Power #38	2/29	400,000.00	3/1/83	13.915%	13.681% "
Central Iowa Power #51	2/29	644,000.00	12/31/14	12.472%	12.283% "
SMALL BUSINESS INVESTMENT COMPANIES					
Associated Capital Corp.	2/20	550,000.00	2/1/83	12.615%	
Realty Growth Capital Corp.	2/20	300,000.00	2/1/83	12.615%	
American Business Capital Corp.	2/20	300,000.00	2/1/85	12.435%	
Hellman, Gal Capital Corp.	2/20	1,000,000.00	2/1/85	12.435%	
Mercantile Dallas Corp.	2/20	4,200,000.00	2/1/85	12.435%	
First Texas Investment Co.	2/20	600,000.00	2/1/90	12.375%	
Florist's Capital Corp.	2/20	500,000.00	2/1/90	12.375%	
Lloyd Capital Corp.	2/20	1,500,000.00	2/1/90	12.375%	
Quidnet Capital Corp.	2/20	300,000.00	2/1/90	12.375%	
STUDENT LOAN MARKETING ASSOCIATION					
Note #234	2/5	1,610,000,000.00	2/13/80	12.799%	
Note #235	2/8	60,000,000.00	2/13/80	12.594%	
Note #236	2/13	1,680,000,000.00	2/19/80	13.039%	
Note #237	2/19	1,700,000,000.00	2/26/80	13.967%	
Note #238	2/26	1,720,000,000.00	3/4/80	14.553%	
TENNESSEE VALLEY AUTHORITY					
Note #124	2/8	70,000,000.00	5/30/80	12.864%	
Note #125	2/18	10,000,000.00	5/30/80	13.375%	
Note #126	2/28	20,000,000.00	5/30/80	14.575%	
Note #127	2/29	305,000,000.00	5/30/80	14.542%	
Seven States Energy Corporation					
Note #5	2/29	15,741,592.43	5/30/80	14.542%	

FEDERAL FINANCING BANK

February 1980 Activity

BORROWER	DATE	AMOUNT OF ADVANCE	MATURITY	INTEREST RATE	INTEREST PAYABLE (other than s/a)
DEPARTMENT OF TRANSPORTATION					
Section 511					
Missouri-Kansas-Texas RR	2/8	650,000.00	11/15/96	11.961%	11.787%quarterly
Chicago North Western 511-78-3	2/11	1,427,924.00	11/1/90	12.002%	
Missouri-Kansas-Texas RR	2/28	250,000.00	11/15/96	13.468%	13.249%quarterly
Emergency Rail Services Act					
Milwaukee Road	2/25	8,574,254.00	7/3/80	14.445%	
National Railroad Passenger Corporation					
Amtrak #21	2/29	5,000,000.00	3/31/80	14.362%	
WESTERN UNION SPACE COMMUNICATIONS, INC.					
	2/1	7,450,000.00	10/1/89	11.133%	11.654%annually
	2/20	4,125,000.00	10/1/89	13.173%	13.607% "

ɔartment of the TREASURY NEWS

IINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
April 15, 1980

REMARKS BY THE HONORABLE ROBERT CARSWELL
DEPUTY SECRETARY OF THE TREASURY
BEFORE THE TWENTY-FIRST ANNUAL MEETING
OF THE INTER-AMERICAN DEVELOPMENT BANK
RIO DE JANEIRO

Introduction

It is a special pleasure to be here in Rio de Janeiro to address this distinguished group on the twentieth anniversary of the first meeting of the governing body of the Inter-American Development Bank. I would like to join my colleagues in reaffirming our strong support for the Bank, its able President, Antonio Ortiz Mena, and our commitment to continued progress in achieving balanced and equitable growth through the hemisphere.

It is a privilege for all of us to be in Brazil and to savor the matchless hospitality of this host country of such spirit and promise. Since 1970, Brazil's real GNP has multiplied five-fold to more than $200 billion; it ranks among the major world industrial powers. Its progress has been the result of resourceful management and planning in which the Bank has played an important role. It is indeed a pleasure to be here and to appreciate at first hand the enormous progress made in the last twenty years.

World Economic Situation and Outlook

The prospects for the world's economy as we enter a new decade are sobering. The problems of the last several years not only remain but will intensify and place added stress on the cooperative international structure which has served the hemisphere well since the end of World War II.

During the next several years, the 1979 surge in oil prices and possible additional increases will exacerbate payment imbalances and consequent financing needs of many countries. The OPEC current account surplus is expected to increase by $55 billion in 1980 to some $120 billion. That will lead to current account deficits in OECD and developing country groups on the order of $70 and $50 billion, respectively, after official transfers.

M-425

Real growth is expected to drop to an average of about 1.5 percent in 1980 in OECD countries, down from 3.3 percent in 1979, while in developing countries it is likely to decline slightly from the five percent achieved in 1979. Despite this modest growth, inflationary pressures may worsen for the world as a whole, as the 135 percent increase in official OPEC oil prices since December 1978 inevitably spills over into other sectors of national economies. For much of 1980, inflation will be in excess of 10 percent for the OECD countries while inflation rates in non-oil developing countries will probably rise above their average 1979 level of 30 percent.

The current world economic outlook for slower growth, soaring oil prices, high inflation and heightened investor caution has inevitably affected the economies of Latin America and Caribbean countries as well. Inflation averaged, for example, more than fifty percent in Latin America last year, and the region's current account deficit increased from $15.8 billion to $20.0 billion over the same period. These and other economic difficulties will require some adjustment over the next several years. They also make clear the critical importance of the long-term development assistance provided by the Inter-American Development Bank and the other multilateral development banks during this difficult period.

U.S. Overall Situation

In the last six weeks the Administration, the Federal Reserve, and the Congress have made a concerted and unprecedented effort to address the critical issues of inflation, energy development and conservation, and slow growth in our economy. A strong, non-inflationary U.S. economy is an important factor in the growth, stability and effective functioning of the world economy and to a sound and stable dollar which plays such a vital role in the world's monetary system. We are determined to get our inflation, energy and other problems under control, and to that end the President has sent to our Congress a revised and balanced budget for our fiscal year 1981.

The Federal Reserve has persevered in bringing our money supply and credit under control. Key elements of a coherent energy program have been, or are about to be, enacted by the Congress, and by the end of 1981, oil prices in the United States will have been fully decontrolled. This program will produce results and may well be the most important contribution the United States can make to improve the economic well-being of Latin America, given the high degree of economic interdependence between our two regions. But it will require discipline and sacrifice in the United States of popular capital and social programs. In that climate of fiscal austerity, it has been and it will be difficult to achieve full support for foreign assistance programs.

But despite the austere economic climate, in his revised budget, the President has protected the development bank legislation from cuts and has made it clear he will maintain strong, undiminished support for Latin American development, The Bank the Fifth Replenishment. The United States understands the concern of every country present over its delay in making its subscriptions to the Fifth Replenishment. We regret that our lengthy and frankly, at times difficult, legislative process has not been completed and that it has not been possible to bring the Fifth Replenishment into effect yet. I am pleased to report, however, that two weeks ago a conference committee of the House and Senate reported out a bill providing full authorization for the U.S. share.

The Administration is currently making every effort to secure final approval of this conference bill when that legislation is returned to the House and Senate floors for a final vote. I am hopeful that legislative action will be completed shortly, which will allow the United States to subscribe to the Replenishment and make payment on its first installment, thereby permitting the Replenishment and the lending program to go forward.

Latin American Outlook in the 1980s

The record for Latin America and the Caribbean over the past two decades that span the work of the IDB shows clear progress. During the 1970s the Latin American economy as a whole continued to expand at a rapid pace and showed remarkable resiliency. Last year regional GDP grew by 6.5 percent, culminating a decade during which average annual growth was 5.9 percent. This compared with 3.5 percent a year expansion rate for developed countries as a group. Over this period per capita income rose from $970 to $1,400, and the area has become much more industrialized. At the same time, Latin America's importance in the world economic system has grown, and we expect this trend to continue during the 1980s. This dynamic growth is a consequence of many factors: improved understanding of the development process, improved planning and administrative capabilities, as well as improved access to capital. These factors should provide the basis for continued progress in the years ahead despite the strained world economic conditions we presently face.

Over the longer term, however, Latin America and the Caribbean will face some major challenges. With an estimated 30 percent of the population still living in desparately poor conditions, widespread poverty remains a major problem. In addition, unemployment and underemployment combined are as high as 40 percent in some countries. A concerted effort is still required to improve the distribution of income both within and among countries and to ensure more efficient utilization of domestic resources.

While impressive gains have been made in many sectors in Latin America, it is disturbing to note that similar progress has not been made in increasing food production. Proverty and and food shortages mean hunger and poor nutrition for millions of people in the hemisphere. That condition is not acceptable to any of us.

We believe that these problems must be met directly and that increased attention must be devoted to them in the years ahead. We expect that the Bank, with its technical expertise and substantial capital resources, will play an important role in this.

The Inter-American Development Bank

Over the past twenty years, the Inter-American Development Bank has played a vital role in assisting Latin American and Caribbean countries in achieving the major goal of balanced development with equity through regional cooperation. Through its lending and technical assistance programs, the Bank has helped to increase member countries' production capacities, strengthen national and regional institutions, improve social services and increase agricultural production. It also has been a catalyst in mobilizing additional domestic resources and attracting additional private external capital to the region.

To a great extent, the success of the IDB's development activities has been due to the Bank's ability to respond to the changing conditions in the region and to find innovative means of fulfilling the region's developmental and capital needs. Over the years, the Bank has been a well-known pioneer in the fields of land reform, integrated rural development, public health and urban development. In recent years, it has broadened its membership and expanded its capital base, reflecting its increasing capital needs and its increasingly important role in the world economic system.

The United States believes that the Fifth Replenishment Agreement establishes a sound framework through which the Bank will be able to continue and to heighten its contribution to development in Latin America and the Caribbean during the 1980s. We are also encouraged by the extent to which the Bank has already moved to implement the terms of the Agreement.

Perhaps the most important aspect of the Fifth Replenishment Agreement is the Bank's new policy for devoting fifty percent of its resources over the 1979-1982 period to low income groups. This policy reflects the conviction of the members of the Bank that in order to attain our goals of broadly based economic and social development, we must devise new ways to reach those who have not fully shared in the fruits of economic and social development in the past. In our view, this must also include a commitment to ensure that all citizens of this hemisphere are accorded their basic human rights and dignity as individuals. This is essential not only to promote ju[illegible], but also because the ultimate success of [illegible] development depends on it.

We also recognize the substantial contribution which the higher income countries are making to assist their poorer neighbors. Because of their cooperation in the Fifth Replenishment, the Bank is better able to direct its resources where they are most needed and thereby do the most to promote more equitable growth in the hemisphere.

The United States would also like to commend the Bank's efforts in the field of energy. With soaring oil costs contributing to severe inflation and balance of payments problems, expansion and diversification of the world's energy supplies are vitally important. The IDB is contributing toward the achievement of that goal by devoting a substantial portion of its lending to energy projects. About one-quarter of the Bank's lending was devoted to the energy sector over the past decade. We are pleased that the Bank will continue to devote a similar proportion of its lending program to this critical sector in coming years. Beyond its activities in traditional energy fields, we believe the Bank should expand lending and technical assistance in other energy-related areas, such as improved energy planning, pricing policies and conservation, the exploitation of renewable non-traditional energy resources, and the development of promising new technologies.

In addition, it is important that the Bank examine further possibilities for mobilizing external resources for the energy and minerals sectors. Substantial private and public investment will be required to develop the potentially large untapped energy and mineral reserves of the region.

In reviewing some of its achievements in recent years, it is clear that the Bank has made a consistent and concerted effort to address and resolve some of the principal development problems confronting the region. Many of these problems will persist into the 1980s, and new challenges will undoubtedly arise. The forthcoming study of the role of the Bank in the 1980s should help identify the major challenges which lie ahead and suggest ways in which the policies established for the Fifth Replenishment period can be refined to meet those challenges more effectively.

Two related problems, which will continue to require close attention over a sustained period of time, are inadequate food supply and rapid population growth. In a majority of Latin American countries, inadequate progress has been made in increasing agricultural production over the last fifteen to twenty years. In fact, many countries in the region are producing less food per capita now than they did twenty years ago. The Bank is aware of this problem, and has taken steps to help increase food production; in 1979, it devoted a third of its lending to the agricultural and fisheries sector. We hope that the Bank will continue to provide a substantial amount of resources for constructing and improving the infrastructure and techniques in this sector so that this disturbing trend in the region's food supplies can be reversed.

Related to the problem of providing adequate food supplies and improving living conditions are the implications of rapid population growth. Population in Latin America has been increasing at a rate of about 2.8 percent per year over the last two decades. Most countries recognize the seriousness of this problem, and the Bank should give increased attention to ways in which it can assist its members in this area.

It will also be important to integrate women more fully in the development process. Moreover, the success of countries' efforts to curb population growth will depend in part on improving the economic opportunities for women.

Conclusion

Once again, on behalf of the United States and its people, allow me to congratulate the Bank, you, Mr. President, and the staff on the 20th anniversary of the Inter-American Development Bank. Undeniably, the record of the IDB, as we mark its first twenty years has been one of remarkable success. The Bank has been instrumental in moving the region through two decades of economic progress despite the global economic turbulence during much of this period. Furthermore, the Bank has emerged in its twentieth year as a stronger institution with a broader capital base, larger membership, and a more ambitious lending program, with new goals in sight as it enters its third decade.

If we all work together with the same spirit of cooperation and build on our experience of the past, the last 20 years will be prologue to another 20 years of progress and fulfillment for the Bank and for the people of Latin America.

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Department of the TREASURY
WASHINGTON, D.C. 20220 TELEPHONE 566-2041
NEWS

FOR IMMEDIATE RELEASE

April 14, 1980

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,500 million of 13-week bills and for $3,500 million of 26-week bills, both to be issued on April 17, 1980, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 17, 1980			:	26-week bills maturing October 16, 1980		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	96.575 a/	13.549%	14.22%	:	93.200 b/	13.451%	14.63%
Low	96.484	13.909%	14.62%	:	93.128	13.593%	14.80%
Average	96.507	13.818%	14.52%	:	93.150	13.549%	14.75%

a/ Excepting 2 tenders totaling $1,150,000
b/ Excepting 3 tenders totaling $2,900,000

Tenders at the low price for the 13-week bills were allotted 76%.
Tenders at the low price for the 26-week bills were allotted 90%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 61,685	$ 61,685	:	$ 75,660	$ 69,660
New York	4,136,425	2,355,825	:	4,556,100	2,655,100
Philadelphia	53,420	48,420	:	29,005	28,215
Cleveland	54,365	53,235	:	38,515	38,390
Richmond	53,385	53,385	:	56,630	56,630
Atlanta	74,900	74,900	:	50,140	50,140
Chicago	506,535	236,535	:	433,855	192,845
St. Louis	60,080	40,080	:	36,375	25,375
Minneapolis	12,655	12,655	:	27,140	22,140
Kansas City	46,455	45,345	:	47,510	47,510
Dallas	31,065	31,065	:	19,640	19,640
San Francisco	500,730	360,730	:	390,670	151,170
Treasury	126,470	126,470	:	143,210	143,210
TOTALS	$5,718,170	$3,500,330	:	$5,904,450	$3,500,025
Type					
Competitive	$3,823,650	$1,605,810	:	$4,050,025	$1,645,600
Noncompetitive	998,410	998,410	:	812,930	812,930
Subtotal, Public	$4,822,060	$2,604,220	:	$4,862,955	$2,458,530
Federal Reserve	700,000	700,000	:	736,395	736,395
Foreign Official Institutions	196,110	196,110	:	305,100	305,100
TOTALS	$5,718,170	$3,500,330	:	$5,904,450	$3,500,025

1/Equivalent coupon-issue yield.

DATE: April 14, 1980

	13-WEEK	26-WEEK
TODAY:	13.818%	13.549%
LAST WEEK:	14.424%	14.226%
HIGHEST SINCE:		
LOWEST SINCE:		
2/15/80 2/25/80	13.700%	13.013%

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STATEMENT BY THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
FOR THE SENATE SUBCOMMITTEE ON APPROPRIATIONS
APRIL 15, 1980, 10:00 A.M.

Mr. Chairman, Members of the Committee:

I am pleased to be here with you to discuss the Department of the Treasury operating budget request for fiscal year 1981.

The Treasury bureau heads will follow me in justifying their individual requests. With your permission, Mr. Chairman, I would like to insert in the record a summary of the highlights of our budget justifications before your Committee.

We are requesting $3.6 billion and 118,377 average positions for our regular operating appropriations for fiscal year 1981. This represents an increase of $35 million and 568 positions over fiscal year 1980, primarily in the Internal Revenue Service. These amounts reflect the President's budget revisions.

Before discussing the Treasury Department's budget requests, I would like to comment briefly on our overall economic policy. As you know, on March 14, President Carter announced strong new measures to arrest inflation. The steps he proposed are bound to be very painful and difficult. But I believe the American people, the Congress and the Administration are now united in their determination to bring inflation under control and to regain control over our economic destiny. This new consensus is the strongest tool of all in the fight against inflation.

The new measures we must take against inflation were developed through one of the most extensive consultations with Congressional leaders in our history. We are greatly heartened by the spirit of cooperation and determination reflected in these discussions.

The new measures mark a substantial intensification of our on-going anti-inflation efforts on every front: restraint in Federal spending to close the budget deficit, restraint on credit expansion, efforts to reduce oil imports, and structural reforms to enhance economic efficiency. The fight against inflation is a dynamic process. It cannot be won by a single "package" of measures. What is required is consistency and persistence, coupled with a willingness to adapt particular policies to

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changing economic circumstances.

Economic circumstances have changed significantly since the time the FY 1981 budget was put together last fall. Through the end of last year, virtually all of the acceleration in inflation was accounted for by energy, and by the higher home financing costs associated with more stringent monetary policy. But in January and February, this inflationary acceleration began to spread into a broad range of goods and services, indicating a worsening of long-term inflationary expectations.

At the same time, increased international tensions gave rise to concerns that expanded defense spending would increase the budget. Fears developed that the 1981 deficit would expand beyond the $16 billion represented by the President's proposals.

These forces also combined to generate serious disturbances in financial markets. Interest rates rose very rapidly on virtually all financial instruments and some financial markets virtually ceased to operate.

It was to respond forcefully to these changes in economic circumstances that the President announced new actions for combatting inflation, coupled with efforts to augment the programs already in place.

First: The balanced budget for FY 1981 that the Administration is submitting to the Congress will be the first balanced budget since 1969. We must recognize that prudent fiscal policy demands that the budget oscillate around a true balance over the business cycle. During the 1970's, we have had continuous deficits, in both good times and bad.

The new budget represents a powerful economic force. The swing toward fiscal restraint between FY 1980 and FY 1981 will be approximately $50 billion, the largest ever in nominal terms and one of the largest ever as a percentage of GNP. And this increased fiscal stringency begins immediately: many of the budget cuts will affect FY 80 as well as 1981, and the gasoline conservation fee already imposed by the President will begin generating revenues this spring.

Because of this shift in fiscal policy, Treasury demands on private capital markets will be reduced substantially. Our borrowing needs will be reduced. In the next fiscal year, there will be a substantial reduction in net new borrowing.

Balancing the Federal budget is the single most important step we can take to reduce inflationary

expectations and return order to capital markets.

Second: By invoking the Credit Control Act of 1969, the President has given the Federal Reserve new tools to slow the growth of consumer and business borrowing.

Much of the strong growth in consumer spending over the last year was fueled by increased consumer debt, and an accompanying decline in the personal savings rate to the lowest level in 30 years. From January 1979 to January 1980, balances due by consumers on bankcards and other revolving credit increased by 17 percent, and consumer loans at finance companies increased by 25 percent. It is essential that consumer borrowing not add further to inflationary pressures, either by stimulating consumption at the expense of savings, or by encouraging consumers to buy now in anticipation of higher prices later.

We have also seen very strong growth in business credit over the last few months. From late December through mid-March, business borrowing from all short-term sources grew at one of the fastest rates ever recorded for a similar period, a development clearly inconsistent with reducing inflation.

Relying solely on the traditional tools of monetary policy to diminish credit growth would have placed unnecessary strains on the financial system. The new tools under the Credit Control Act will mitigate that stress. However, there actions imply no diminution in the Fed's commitment to deploy the conventional tools of monetary policy as an anti-inflationary weapon. The President invoked the Act in ways carefully designed to complement and make more effective the traditional methods of monetary control.

Third: The 10 cent per gallon gasoline conservation fee provides further impetus toward the vital objective of reducing our use of imported oil. Twice in the last 10 years, in 1974 and 1979, we experienced dramatic increases in the price of imported oil; both times inflation worsened seriously worldwide. In 1979 alone, the price of imported petroleum increased by about 100%. To regain control of our own economic destiny, we must reduce our dependence on imported oil.

We estimate the gasoline conservation fee will reduce oil imports by about 100,000 b/d in the short-run, and as much as 250,000 b/d over the longer-run. The fee is a transitional measure; the Administration will submit to the Congress a tax equivalent to an ad valorem tax on motor fuels. Once it becomes effective, the new equivalent ad valorem tax will replace both the present 4 cents a gallon tax and the conservation fee.

The steps the President took on March 14, in concert with the programs already in place, comprise a comprehensive attack on the major factors contributing to inflation. The program addresses the root causes of inflation, not merely the symptoms. We have endured a decade of persistent budget deficits, very high inflation, and soaring oil import bills. Reversing these trends will take firm and patient leadership. I believe, however, that we will succeed. What we are witnessing in Washington and throughout the nation is, in my judgment, the formation of a new and deep commitment to a process of economic renewal.

Let me return now to the Treasury Department's fiscal year 1981 budget.

Fiscal Year 1981 Treasury Overview

As I mentioned before, the estimates contained in the President's budget for fiscal year 1981 indicate that the Treasury will require a total of $3.6 billion for operating accounts.

I would like to bring to the Committee's attention some of the highlights of the type and level of workload facing the Department in fiscal year 1981. For example:

- The Department will process over 139 million tax returns in fiscal year 1981, an increase of over 2 million from the previous year.

- We expect an increase of over 9 percent in delinquent tax accounts processed and secured.

- We estimate that 40.3 million taxpayers will come to us for assistance.

- We anticipate that 284 million persons will be arriving at U.S. borders -- 3 percent more than in 1980 -- and that we will be processing almost 5 million formal entries -- almost 7 percent more than 1980.

- We expect to manufacture approximately 15 billion coins in 1981.

- Over 153 million savings-type securities will be issued and almost 163 million retired.

- The Department will also issue 729 million checks, an increase of over 2 percent.

The $3.6 billion request for 1981 represents a net increase of $35 million and 568 average positions over 1980 levels. Of the total, $34 million and 409 average

positions are needed to handle additional workload generated outside the Department and is totally uncontrollable by us. The Internal Revenue Service will need $22 million of this amount for processing and examining additional tax returns, collecting delinquent taxes and for legal services. $10 million will be needed by the Bureau of the Public Debt for issuing and redeeming securities, while the remaining $2 million is for other miscellaneous increases.

The major program expansion -- that is, an increase in the quality of our programs -- contained in our estimates involves $36 million and 1,166 average positions. This program increase is made up of several major items and many small but necessary items scattered throughout the Department. The increases are shown below:

-- $20.9 million and 989 average positions to provide resources in the Internal Revenue Service for matching of information returns and follow-up collections -- with an estimated revenue return of $375 million.

-- $5.1 million to provide for site preparation at several IRS Service Centers in support of the ADP Equipment Replacement Program.

-- $3.0 million and 135 average positions to provide additional resources in the IRS to collect unpaid accounts -- producing a revenue return of approximately $55 million.

-- $6.9 million and 42 average position for other program increases spread across the other Treasury Bureaus.

These increases are offset by a net reduction of $34.5 million and 1,007 average positions. This represents the cost of maintaining current operating levels on Treasury programs offset by one-time costs savings, management improvements, and productivity savings.

The operating accounts in the budget estimate reflect our continuing effort to strike a reasonable balance between the Department's program needs and the desire to stabilize the growth in Government spending. The increases in this budget do help offset the impact of inflation on the Department. It is my view that the budget estimate before you will assure that the revenue is protected, that income tax returns are processed, that customs declarations and duties are effeciently collected and deposited, and that alcohol and tobacco excise taxes are promptly collected. It provides adequate funding to secure necessary financing to pay the Government's bills and maintain the Government books

In addition, the budget estimate provides for an even-handed law enforcement effort. While the significant responsibilities for law enforcement rest with the Department of Justice, the Treasury Department is responsible for that segment of law enforcement related to the protection of currency, the tax system, and the customs and excise taxes, as well as regulation and control of firearms, explosives, and smuggling.

I would like to insert Table 2 into the record to show the relationship between our average position and dollar requirements, as well as Table 3, which illustrates the detailed derivation of Treasury's "proposed authorized level for 1980."

Mr. Chairman, this concludes my prepared statement. I shall, of course, welcome the opportunity to answer any questions you may have. Thank you.

Table 1

THE DEPARTMENT OF THE TREASURY

Annual Approporiations for the FY 1980 and
Estimates Requirements for FY 1981

(In Millions of Dollars)

	1980 Proposed Authorized Level	Revised 1981 Budget Estimates	Increase (+) Decrease (-) Compared to 1980
gular Operating Appropriations:			
Office of the Secretary	$ 31.8	$ 34.0	$ +2.2
International Affairs	22.8	23.7	+.9
Federal Law Enforcement Training Center	13.4	13.4	---
Bureau of Gov't Financial Oper:			
Salaries and Expenses	190.0	188.0	-2.0
Payments to Guam, V.I. and American Somoa	2.0	---	-2.0
Government Losses in Shipment	.2	---	-.2
Bureau of Alcohol, Tobacco and Firearms	143.7	144.8	+1.1
U.S. Customs Service	464.3	465.7	+1.4
Bureau of the Mint:			
Salaries and Expenses	59.4	61.0	+1.6
Bureau of the Public Debt	209.6	196.6	-13.0
Internal Revenue Service:			
Salaries and Expenses	150.0	157.8	+7.8
Taxpayer Ser. & Returns Proc.	802.7	811.7	+9.0
Examinations and Appeals	837.3	852.9	+15.6
Investigations and Collections	501.4	536.7	+35.3
Total, Internal Revenue Ser.	2,291.4	2,359.1	+67.7
Payment Where Energy Credit Exceeds Tax Liability	1.9	---	-1.9
J.S. Secret Service	177.7	157.0	-20.7
TAL, Regular Operating Appro.	$3,608.2	$3,643.3	$+35.1

Table 2

THE DEPARTMENT OF THE TREASURY

Comparative Statement of Average Positions
Fiscal Year 1980 and 1981

(Direct Appropriations Only)

	1980 Authorized Level	Revised 1981 Budget Estimate	Increase (+) Decrease (-) Compared to 1980
Regular Operating Appropriations:			
Office of the Secretary	787	798	+11
International Affairs	487	458	-29
Federal Enforcement Training Center	253	256	+3
Bureau of Gov't Financial Oper.	2,750	2,696	-54
Bureau of Alcohol, Tobacco and Firearms	3,778	3,737	-41
U.S. Customs Service	13,643	13,529	-114
Bureau of the Mint	1,722	1,710	-12
Bureau of the Public Debt	2,679	2,640	-39
Internal Revenue Service:			
Salaries and Expenses	4,558	4,666	+108
Taxpayer Ser. & Returns Proc.	34,995	34,141	-854
Examinations and Appeals	30,367	30,292	-75
Investigations and Collections	18,264	19,928	+1,664
TOTAL, IRS	88,184	89,027	+843
U.S. Secret Service	3,526	3,526	---
TOTAL, Regular Operating Appro.	117,809	118,377	+568

Table 3

THE DEPARTMENT OF THE TREASURY
Derivation of "Proposed Authorized Level for 1980"
(In Thousands of Dollars)

1980 Appropriation..$3,435,622

<u>Proposed Supplementals</u>:

1. Pay Increase:

   a. Classified............................$132,284
   b. Wage Board...........................   229   +132,513

2. Program:

   a. <u>Government Financial Operations</u> (Payments to Virgin Islands) - This proposed supplemental appropriation would provide funds to reimburse the Government of Virgin Islands for losses incurred under the Tax Reduction and Simplication Act of 1977.......................$2,000

   b. <u>Internal Revenue Service</u> (<u>Payment Where Energy Credit Exceeds Tax Liability</u>) - Provides for additional payments to businesses when the solar wind credit due them exceeds the amount of tax liability owed........................$1,000

   c. <u>Public Debt</u> - Provides for increase workload occurring in savings bond redemptions, Treasury bill book-entry accounts, and other Bureau operations...........................$23,558

   d. <u>Secret Service</u> - Provides for the increase cost of protective travel, Presidential candidate and nominee protection (10,800) and reimbursements to State and Local governments for protection of foreign diplomatic missions under extraordinary circumstances (2,750)...$13,550   +40,108

<u>Proposed Appropriation Transfer</u>:

1. Office of the Secretary (transfer of Anti-Dumping and Countervailing Duty Program to Commerce)   -329

2. International Affairs (transfer to Special Trade Representative)   -88

3. U.S. Customs Service (transfer of Anti-Dumping and Countervailing Duty Program to Commerce)   -5,271

4. U.S. Secret Service (transfer from Mint construction account to fund pay increase requirements)   +5,730   +42

..........................$3,608,285

THE DEPARTMENT OF THE TREASURY

HIGHLIGHTS OF THE PRESIDENT"S FY 1981 BUDGET

The President's Budget for the Department of the Treasury Requests $79,001,042,000 for FY 1981 -- a decrease of $16,333,208,000 compared to 1980. This represents an increase of $6,300,000,000 for interest on the public debt, an increase of $75,118,000 for operating accounts ($35,070,000 under Treasury-Post Office Subcommittee, $40,246,000 under Hud-Independent Agencies Subcommittee and a decrease of $198,000 under the State, Judiciary and Commerce Subcommittee), and a decrease of $22,708,326,000 in all other accounts, such as trust funds and revolving accounts, receipts, energy security corporation, and indefinite accounts. Funds for the Department's operating programs total $3,741,365,000 an increase of $75,118,000 over 1980. These operating programs are the ones that receive the most scrutiny by our Congressional Appropriations Committees.

Relative to the Department's employment, the budget provides for a 1981 level of 118,555 average positions (118,377 under Treasury-Post Office Subcommittee, and 158 under HUD-Independent Agencies Subcommittee and 20 under the State, Judiciary and Commerce Subcommittee) for the operating accounts, an increase of 576 (568 under Treasury-Post Office Subcommittee and 8 under the State, Judiciary and Commerce Subcommittee) compared to 1980.

Budget Authority Increases for Treasury Subcommittee Operating Accounts -- Net $35,070,000

+ 33,799,000 -- to meet workload increases, for the following items: $8.2 million for processing tax returns, $4.1 million for examination of tax returns, $7.0 million for collection of delinquent taxes, $3.0 million for legal services, $1.2 million for check issuance, $9.7 million for issuing and redeeming securities, $0.3 million for Office of the Secretary workload, and $0.3 million for other increases.

+ 20,869,000 -- to provide additional resources in the Internal Revenue Service for matching of information returns and follow-up collections.

+ 5,081,000 -- to provide for site preparation of several IRS Service Centers in support of the ADP equipment replacement program.

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Increases - Operating Accounts (continued)

+ 2,980,000 -- to provide additional resources in the IRS to collect unpaid accounts.

+ 600,000 -- for repairs and improvements to the Treasury Annex elevators.

+ 2,937,000 -- to provide for acquisition of equipment in several Treasury bureaus.

+ 350,000 -- to provide additional resources in the Secret Service for technical security.

+ 700,000 -- for the Salary Equalization Program, Asian Development Bank.

+ 2,292,000 -- for other program increases.

+ 90,179,000 -- to maintain current levels of operation -- within-grade promotions, grade to grade promotion, space rental, FTS costs, printing costs, health benefits, etc.

-124,717,000 -- for non-recurring equipment, one-time costs, and savings and certain program reductions.

Employment - Increase of 568 Average Positions

+ 409 -- average positions of new employees to meet workload increases for the following items: 397 for collection of delinquent taxes, 10 for manufacturing of coins in Mint, 2 for the Office of the Secretary and Government Financial Operations.

+ 989 -- average positions to provide additional resources in IRS for matching of information returns and follow-up collections.

+ 135 -- average positions to provide additional resources in IRS to collect delinquent unpaid accounts.

+ 10 -- average positions for the check payment and reconciliation program in GFO.

+ 32 -- average positions for other program increases.

+ 34 -- average positions to provide full-year cost in 1981 for programs authorized for part of 1980.

- 1,041 -- average positions for non-recurring savings, program reductions, and productivity savings.

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Assumptions

The estimates are based on the assumptions that:

-- All possible efforts will be made to hold Government expenditures to a minimum particularly in this budget year when most workload increases have been offset by productivity savings and program reductions.

-- Pay increases for classified employees under Executive Order 12165 will be provided in 1980 supplemental appropriations.

-- Increased productivity and management savings will be applied to the maximum extent.

-- Demands for Treasury services will continue to increase and must be met:

* Government checks issued and paid.

* Bond and security records maintained.

* Coins, currency and stamps produced for nation's commerce.

* Internal Revenue master file maintained in a current manner and tax returns processed.

* Check claims cases settled promptly.

* Cargo and persons entering our borders should be processed equitably and efficiently.

* Smuggling of all contraband should be identified and halted where possible.

Summary Analysis of FY 1981 Estimates for Operating Bureaus and Offices

Office of the Secretary - $33,995,000

-- Net increase is $2,241,000 and 11 average positions of employment.

-- $344,000 and 8 average positions are needed for increased workload.

-- $600,000 is requested for repairs and improvements to the Treasury Annex elevators.

-- $325,000 and 10 average positions are included for the new insurance office.

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Office of the Secretary (continued)

-- $1,477,000 and 2 average position are needed to maintain current levels of operations - within-grade promotions, annualization of pay increases, space rental costs, etc.

-- A reduction of $505,000 and 9 average positions are principally for non-recurring and one-time costs and productivity savings.

International Affairs - $23,671,000

-- Net increase is $834,000 and a decrease of 29 average positions of employment.

-- $700,000 is required for the Salary Equalization Program, Asian Development Bank.

-- $1,558,000 is provided to maintain current levels of operation -- within-grade promotions, price increases, annualization of pay increases, etc.

-- A reduction of $1,424,000 and 29 average positions is for productivity savings and non-recurring one-time costs.

Federal Law Enforcement Training Center - $13,400,000 for Salaries and Expenses

-- Net decrease for Salaries and Expenses of $2,000 and an increase of 3 average positions of employment.

-- An increase of $753,000 and 3 average positions are for the costs related to maintaining current levels of operations -- within-grade promotions, annualization of pay increases, price increases, etc.

-- A reduction of $755,000 is for productivity savings, program reductions, and non-recurring one-time costs.

Bureau of Government Financial Operations

Salaries and Expenses - $188,012,000

-- Net decreases are $2,027,000 and 54 average positions of employment.

-- $1,193,000 and a decrease of 6 average positions are for workload in the check issuance area.

-- $490,000 is to provide for ADP and capital equipment acquisitions.

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GFO, Salaries and Expenses (continued)

-- $486,000 and 10 average positions are for the check payment and reconciliation program.

-- $229,000 and 5 average positions are for other program increases.

-- $1,539,000 is required to maintain current staff levels -- within-grades, space rental, annualization of postage increases and full-year costs of programs authorized for part of 1980.

-- Reductions of $5,964,000 and 63 average positions for management savings, non-recurring one-time costs and program reductions.

Payments to Guam, Virgin Islands and American Samoa - $-2,000,000

-- A net reduction of $2,000,000 for one-time payments occuring in 1980.

Government Losses in Shipment - $-200,000.

-- A net reduction of $200,000 for one-time payment occuring in 1980.

Bureau of Alcohol, Tobacco and Firearms - $144,844,000

-- A net increase of $1,142,000 and a reduction of 41 average positions of employment.

-- $997,000 is required for additional equipment.

-- $3,666,000 is for costs to maintain current levels of operations which include such items as within-grade promotions, grade to grade promotions, and increased printing, postage, and space costs.

-- A reduction of $3,521,000 and 41 average positions for program reductions and non-recurring costs and savings.

U.S. Customs Service - $465,700,000

-- Net increase of $1,361,000 and a reduction of 114 average positions of employment.

-- $1,450,000 is for additional vehicles and enforcement equipment.

-- $386,000 and 8 average positions are for the regulatory audit program.

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U.S. Customs Service (continued)

-- $525,000 and 9 average positions are for safety and health programs.

-- An increase of $11,467,000 and 29 average positions are to maintain current levels of operation -- within-grade promotions, grade to grade promotions, price increases, annualization of pay increases, space increases, etc.

-- A reduction of $12,467,000 and 160 average positions are for non-recurring costs and savings, productivity savings, and program reductions.

Bureau of the Mint

Salaries and Expenses - $60,956,000

-- Net increase for Salaries and Expenses, $1,599,000 and a decrease of 12 average positions.

-- $205,000 and 10 average positions are for increased worklo

-- $4,323,000 is required to maintain current levels of operation -- within-grade promotions, annualization of pay increases, FTS costs, etc.

-- A reduction of $2,929,000 and 22 average positions is for non-recurring costs and savings and program reductions.

Bureau of the Public Debt - $196,625,000

-- A reduction of $13,015,000 and a reduction of 39 average positions of employment.

-- $9,671,000 is for compensation of issuing and paying agent for redemption and sale of savings bonds and reimbursement to Federal Reserve Banks for services.

-- $341,000 is for other program increases.

-- $2,418,000 to maintain current levels of operations, inclu ing such major items as within-grade promotions, annualiza tion of pay increases, space rental costs, annualization o postage, etc.

-- A reduction of $25,445,000 and 39 average positions for no recurring costs, and management savings.

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Internal Revenue Service - $2,359,111,000

Salaries and Expenses - $157,762,000

-- A net increase of $7,782,000 and 108 average positions of employment.

-- $3,152,000 and 63 average positions are for increased workload.

-- $6,678,000 and 60 average positions are to maintain current levels of operations -- within-grade promotions, annualization of pay increases, space rental costs, etc.

-- A reduction of $2,048,000 and 15 average positions covering non-recurring costs and savings and program reductions.

Taxpayer Service and Returns Processing - $811,744,000

-- Net increase of $8,996,000 and a decrease of 854 average positions of employment.

-- $8,202,000 and 4 average positions for processing additional tax returns.

-- $5,750,000 and 302 average positions are for matching additional information returns and related follow-up collections.

-- $5,081,000 is for site preparation at several service centers in support of the ADP Equipment Replacement Program.

-- An increase of $13,856,000 and a reduction of 812 average positions is to maintain current levels of operations including such items as within-grade promotions, grade-to-grade promotions, annualization of pay raises, etc.

-- A reduction of $23,893,000 and 348 average positions is for non-recurring costs and savings and program reductions.

Examinations and Appeals - $852,925,000

-- A net increase of $15,609,000 and a decrease of 75 average positions of employment.

-- An increase of $4,069,000 for examination of additional tax returns.

-- An increae of $4,527,000 and 233 average positions for examinations of tax returns derived from the information returns program.

IRS, Examinations and Appeals (continued)

-- An increase of $19,103,000 and a reduction of 63 average positions are to maintain current levels of operations including such items as within-grade promotions, grade-to-grade promotions, annualization of pay increases, etc.

-- A reduction of $12,090,000 and 245 average positions is for non-recurring costs and savings and productivity savings.

Investigations and Collections - $536,680,000

-- A net increase of $35,259,000 and 1,664 average positions of employment.

-- $6,963,000 and 330 average positions are for collection of delinquent taxes related to additional workload.

-- $10,592,000 and 454 average positions are for follow-up investigations derived from the information returns program.

-- $2,980,000 and 135 average positions are for an increased effort to collect unpaid accounts.

-- $21,002,000 and 815 average positions to maintain current levels of operation -- within-grade promotions, grade-to-grade promotions, space rental costs, annualization of pay increases and programs authorized for part of FY 1980 etc.

-- A reduction of $6,278,000 and 70 average positions covering non-recurring costs and savings and program reductions.

Payment where Energy Credit Exceeds Tax Liability - $-1,900,000

-- Net decrease of $1,900,000 for one-time non-recurring costs in 1980 (this account is proposed as an indefinite in 1981).

U.S. Secret Service - $157,041,000

-- Net decrease is $20,609,000 with no change proposed in average positions.

-- $350,000 is for technical security equipment.

-- $2,339,000 is for those costs required to maintain current levels of operation -- within-grade promotions, grade-to-grade promotions, annualization of pay, space rental, etc.

-- A reduction of $23,298,000 is for non-recurring equipment costs and program reductions primarily related to the candidate and nominee protection program in the 1980 budget.

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Statement of
Daniel I. Halperin
Deputy Assistant Secretary (Tax Legislation)
Before the
House Committee on Ways and Means
April 15, 1980

Mr. Chairman and Members of this Committee:

I am pleased to have the opportunity to appear before this Committee to discuss H.R. 6806 and H.R. 3165. Both bills deal with aspects of the rules of the Internal Revenue Code that require the investment credit and the tax deferral attributable to accelerated depreciation to be "normalized" in establishing rates for regulated public utilities. Last year the Treasury presented extensive testimony on this subject before the Committee's Oversight Subcommittee. For the record of these hearings I am attaching a copy of our previous testimony, which I will not reiterate in detail.

As we testified last year, the Treasury regards the investment credit, and the tax deferral attributable to the excess of accelerated over economic depreciation, as subsidies to investment that are delivered through the tax system. As we also testified at those hearings, the Treasury has concluded that it is appropriate for these tax subsidies to be made available to regulated public utilities, which are among the most capital-intensive industries in the country; but that, as long as these benefits are available to regulated public utilities, they should be treated as subsidies to investment rather than as simple tax reductions.

This point should be underscored. We would not be here today if the cash equivalent of the investment credit and the loan equivalent of the tax deferral attributable to accelerated depreciation were delivered directly rather than through the tax system. We do not believe that accounting for comparable, but appropriated, subsidies would be

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controversial. The fact that they are cleared through the tax system does not change -- and should not be permitted to obscure -- their essential character. Thus, in regulated ratemaking, they should be treated in the same manner as any comparable appropriated capital subsidy. Neither should be considered to reduce current regulated tax expense. The investment credit should be treated as a 10 percent reduction in the price paid for equipment, and the tax deferral attributable to accelerated depreciation as an interest-free loan. We believe that this treatment -- "normalization" -- is unquestionably the correct method of accounting for these subsidies; and that, in the long run, such treatment is in the interests of ratepayers as well as owners of equity in regulated utilities. On balance, we also concluded last year that the normalization requirements of the Internal Revenue Code constitute an appropriate means to ensure proper accounting for these subsidies.

Quite obviously there are those who do not share our point of view. Specifically, the regulatory authorities in the state of California have accounted for the subsidies in a manner that is the equivalent of their being "flowed through" to income (i.e., as a reduction of current tax expense), a result that does not comport with the rules of the Code. But we recognize that the forces that have led to the existing situation in California are both complex and politically charged. Consequently, while we believe the method of regulatory accounting adopted by California unquestionably violates the applicable provisions of the Code and regulations, the Treasury is willing to offer its cooperation in attempting to arrive at a solution to this difficult situation. But we must insist that one can expect as part of any legislative solution a reduction, if not the elimination, of further major disputes about the operation of these rules.

It is with that point of view that we approach H.R. 6806. H.R. 6806, as we understand it, has two objectives. First, under existing law, failure to normalize results in a loss of the benefits of the investment credit and accelerated depreciation. Sections 3 and 4 of H.R. 6806 would operate to absolve those companies, which have been required by California to flow through improperly the investment credit and the tax deferral attributable to accelerated depreciation, from the loss of those benefits. Second, recognizing that the improper flow-through stemmed primarily from an estimating procedure adopted by the California Public Utilities Commission, sections 1 and 2 of H.R. 6806 would amend the investment credit and accelerated depreciation rules to state specifically in the statute that such procedures are impermissible.

We believe that the statutory clarifications of sections 1 and 2 of H.R. 6806 are consistent with existing law and, therefore, are appropriate. The balance of H.R. 6806 we view

with reservation. Regulated public utilities are among the most capital-intensive industries and therefore are among the most significant recipients of capital subsidies delivered through the tax system. Consequently, retroactive disallowance of these subsidies exposes the companies subject to the California rate orders to tax deficiencies that by any measure are substantial. If, by reason of legislation, the difficult circumstances as they have developed in California could be defused and the normalization rules made to operate properly there as elsewhere, we see no policy that would be served by collecting such deficiencies.

The difficult question is whether H.R. 6806 can achieve this goal, which both we and its sponsors seek. In our judgment, legislative relief for past violations would be preferable if it preserved some measure of sanction short of collecting the full tax deficiencies or insisting on complete abatement of the rate refunds that already have been ordered by California. Such legislation might serve to defuse the existing situation while making clear that the normalization rules cannot be disregarded with impunity.

But the Treasury is not unalterably opposed to H.R. 6806. _If_, as the result of its enactment, the situation in California could be defused and the California authorities persuaded to accept normalization; and _if_ it was considered unlikely that other state regulatory authorities would be induced to start down the road taken by California; and _if_, finally, this Committee and the Congress were to make it clear that attempts to circumvent these rules in the future would meet with no sympathy on the part of the Congress, then a measure such as H.R. 6806 could be desirable.

Whether it is realistic to have such expectations -- which, Mr. Chairman, I emphasize _are_ in our judgment essential to the Treasury's acquiescing in this legislation -- it is not yet possible to say. If the California authorities, and those public lawyers whose intervention in the California rate proceedings has been an essential feature of this controversy, were prepared to accept normalization for the future, that action would go far toward alleviating our concerns. We say this recognizing that the Supreme Court of California, which we assume cannot speak to the question outside the confines of a judicial proceeding, also has played an essential role in California. But we also point out that, in considering the wisdom of H.R. 6806, this Committee must also reach a judgment about the possibility that its enactment would induce other state regulatory authorities to follow California's lead. We are not in a position to express an independent judgment on the likelihood that this will happen. Perhaps the Committee will hear from witnesses, subject to regulation by states other than California, who will make their views on this subject known.

We must point out, however, that if H.R. 6806 were enacted, and if, contrary to the Committee's expectations, California persevered in the course that it has staked out, or other public utility commissions were persuaded to follow California's lead, the consequences could be quite serious. Our testimony last year to the effect that retention of the normalization rules was appropriate rested on several fundumental premises, among them that the subsidies provided by the investment credit and accelerated depreciation were appropriate for regulated public utilities as long as they were properly accounted for through normalization; that, in general, the tax normalization rules seemed to operate properly; and that, absent such rules, benefits that are intended as subsidies to investment well might be converted into rate subsidies. But we also pointed out that these rules do <u>not</u> operate well when they are the focus of controversy. If, either as the result of California's continued pursuit of flow-through or because of efforts by other public utility commissions to follow suit, the normalization rules prove to be a source of even further controversy, the Treasury might feel constrained to recommend a review of Congressional policy toward the provision of these investment subsidies to regulated public utilities. It might prove necessary to re-examine the wisdom of retaining the normalization rules. Or, recognizing that flow-through operates to convert investment subsidies into direct rate subsidies, the inability to achieve normalization accounting might warrant reconsideration of allowing these tax subsidies to regulated utilities. We do not mean to suggest that the time for such reconsideration has arrived; only that, if these rules cannot be made to work properly, the underlying policy may have to be reconsidered.

As I mentioned at the outset, Mr. Chairman, the Treasury is prepared to work with this Committee and other interested parties in an attempt to remedy this difficult situation. At this moment we are not confident that H.R. 6806 will provide a solution. We look forward to seeing how the situation develops, and in particular to the views to be expressed before this Committee in the balance of its hearings today.

The other bill dealt with in this hearing, H.R. 3165, addresses the appropriate <u>technique</u> of normalizing the investment credit. It is the Treasury's view that the investment credit was intended to stimulate investment in productive capital by reducing the cost of capital goods. Such a reduction means that investments will become feasible at a lower level of expected returns than would be the case in the absence of the credit. Thus, we believe that proper normalization of the credit would result in its being accounted for in regulated ratemaking in exactly the same way as any other 10 percent reduction in capital costs. <u>First</u>, the regulated taxpayer's "rate base," to which its "fair rate of return" is applied in determining the allowable return to

equity investors, would be reduced by the amount of the credit. This would reflect the fact that a portion of the taxpayer's investment had been financed by the government. Second, the base for determining regulated depreciation expense would also be reduced by 10 percent (to reflect the actual cost of the investment), thus reducing annual depreciation charges (and, hence, regulated "cost of service") by 10 percent as well.

In its current form, section 46(f) may not quite accomplish this goal. It provides two alternative methods of normalizing the investment credit, neither of which unambiguously permits both a rate base reduction and a reduction in regulated depreciation base. Under one method -- section 46(f)(1) -- the regulatory body establishing rates may require the regulated taxpayer's rate base to be reduced by the amount of the credit. However, under section 46(f)(1), it is not clear that any other reduction, for example a reduction in depreciation expense, is permitted in the taxpayer's regulated cost of service. Under the alternative -- section 46(f)(2) -- regulated "cost of service" may be reduced by a ratable portion of the credit earned each year (the equivalent of reducing the taxpayer's base for computing regulated depreciation expense), but the taxpayer's rate base may not be reduced. Consequently, section 46(f)(2) permits the regulated taxpayer to earn a return on the portion of its investment that is paid for by the government through the credit. Most regulated utilities elect section 46(f)(2).

As we testified last year, we believe that the correct technique by which to normalize the investment credit involves a combination of the two existing methods, under which, through reduced depreciation, the regulated taxpayer's cost of service is reduced by a ratable portion of the credit each year; while, simultaneously, the taxpayer's rate base is reduced (to exclude the government's contribution) by the amount of the allowable credit. This treatment would recognize the investment credit as providing a 10 percent reduction in capital costs.

We are convinced that the arguments in support of retaining section 46(f)(2) are based on a misunderstanding of the way in which the investment credit was intended to operate. Many of those who have considered this issue agree that conceptually we are correct, but attempt to justify section 46(f)(2) on other grounds. Specifically, it has been said that allowing a regulated utility to preserve the investment credit in its rate base, as permitted by section 46(f)(2), to some extent mitigates the consequences of "regulatory lag" (i.e., the inability of current ratemaking orders to keep up with financial demands on a regulated utility), a phenomenon that is aggravated by high rates of inflation. We believe that it simply is improper to justify

improper normalization of the investment credit as an antedote to deficiencies in the ratemaking process. Those deficiencies, if they exist, should be remedied by the regulators.

In sum, Mr. Chairman, H.R. 3615 attempts to correct what we regard as a deficiency in the existing investment credit normalization rules. While we have some technical reservations, the Treasury supports the objective of H.R. 3615 and would be happy to cooperate with the Committee or its staff to work out suitable revisions.

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STATEMENT OF
EMIL M. SUNLEY
DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)
BEFORE THE
OVERSIGHT SUBCOMMITTEE OF THE
COMMITTEE ON WAYS AND MEANS

Mr. Chairman and members of the Subcommittee:

I welcome this opportunity to appear before you to discuss several important issues involving the distribution of subsidies through the tax system to regulated utilities. This subject is not only of great interest to the Congress and the Administration, but also to regulators, ratepayers and utilities throughout the country.

Let me begin by recalling for the Subcommittee why it is that a tax policy official is testifying before a tax committee on a subject of fundamental importance to regulated utilities, ratepayers and regulators. The issues before the Subcommittee involve two general subsidies to capital formation provided through the Internal Revenue Code: accelerated tax depreciation and the investment tax credit.

When tax depreciation rules permit write-offs at a faster rate than the actual physical deterioration of capital assets, the economic effect is the deferral of tax liability. The result is the same as if the Treasury were to extend a series of interest-free loans to the taxpayer during the early years of the asset's life, which are repayable in the later years.

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The other subsidy -- the investment credit -- was the subject of extensive testimony before the Subcommittee this past week. This credit is roughly equivalent to a direct cash grant paid by the Treasury to purchasers of certain capital assets. The grant is paid by allowing taxpayers to reduce their tax liabilities otherwise payable.

Thus, we are talking about two forms of Federal subsidies -- interest-free loans and cash grants -- which are "cleared" -- that is, paid and distributed -- through the Federal income tax system.

If these subsidies had been enacted as direct grant and loan programs administered by the Commerce Department, then not only would we be before a different committee, but most of the issues before us would never have arisen. This is because under a direct loan or grant program, the real character of the payments to assist private capital formation would be obvious to all concerned. The accounting treatment for government grant and loan assistance is simply not controversial in the private sector. Consequently, there would be no need to prescribe accounting rules by Federal law and, therefore, no need to exercise oversight review of such rules.

That we are here at all may be the most persuasive reason for exercising greater restraint in the future when we are tempted to use the tax system as a mechanism to finance Federal subsidy programs. Programs whose objectives and costs are obscured by the method chosen to finance them and whose administration becomes intertwined with administration of the income tax laws impose unnecessary social and political costs we can ill-afford to bear.

Why Provide These Subsidies to Regulated Utilities?

The investment credit, as originally proposed by the Treasury Department in 1962, would have completely excluded public utilities from the credit. The Treasury argued that, "Investments by these regulated monopoly industries are largely governed by determined public requirements and are subject to regulated consumer service charges designed to provide a prescribed after-tax rate of return on investment". The House Ways and Means Committee compromised by giving the public utilities one-half the credit allowed other industries. The Committee justified the decision as follows:

> The smaller credit [for public utilities] is provided ... because much of its benefit in these regulated industries is likely to be passed on in lower rates to consumers, thereby negating much of the stimulative effect on investments. Moreover, the size of the investment in regulated public utilities ... will in large part be determined by the growth of other industries, rather than their own.

The reasoning reflected in the Treasury and Ways and Means statements prevailed until 1975 when Congress placed regulated companies on the same footing as all other companies for investment credit purposes. It is clear today that the earlier reasoning is essentially wrong. In both the regulated and unregulated sectors of the economy, technology and consumer preferences operate to determine which particular forms of capital will be employed and which kinds of output will be increased. If the full beneficial effect of an investment tax credit for machinery and equipment is to be achieved, it should be made generally available, on the same terms, to all sectors of the private economy -- to the regulated as well as to the unregulated. Only in this way can the structure of product prices and the output mix of the private sector fully reflect technological possibilities and consumer preferences. The capital cost of goods produced by the regulated sector should not be made arbitrarily higher or lower than the capital cost of goods produced by the unregulated sector.

A second argument often made for denying the full investment credit to regulated utilities is that the regulatory process inherently biases public utilities to excessive use of capital. As a purely abstract principle, a case can be made that as long as the average "fair rate of return" allowed by the regulators exceeds the marginal cost of funds, the management of regulated utilities will have an incentive to utilize more capital intensive production methods. However, there are several factors in the real world which tend to reduce this effect.

First, the familiar regulatory lag in adjusting the prices of utility services to rising costs will operate to prevent the realization of higher returns from marginal investments. Related to this, is the fact that the regulatory authorities themselves may adjust downward the fair rate of return thus offsetting the tendency toward excessive capital intensity.

Similar checks are provided by competition among utilities (e.g., gas or electric power) and between utilities and large companies able to produce their own utility services. Finally, to the extent that utilities are interested in maximizing sales rather than profits there would be no pressure for excessive capital intensity.

Attempts at empirically estimating the degree of excessive use of capital in the utility sector have not adequately come to grips with the difficulties in measuring the marginal cost of funds relative to the average "fair" rate of return or with the ability of regulators to adjust the fair rate of return as conditions warrant. Indeed, throughout the history of regulation, we have seen large variations in the profits of utilities and in their ability to attract funds in capital markets, all while a "fair" return was presumably being earned.

Thus, we would conclude that it would be unwise policy to offset a theoretically possible excessive use of capital by utilities by denying to them an instrument designed generally to stimulate capital formation.

Phantom Taxes

Let us now turn to the question of "phantom taxes". This is an issue of perception, not of economics, financial accounting, or fairness. The phantom tax problem evolves from the natural response of a utility ratepayer who is told that he is being charged a greater amount for utility income tax liability -- a part of his cost of service -- than the utility actually pays as taxes. Of course, what the ratepayer does not see and is not told is that part of the utility's tax liability is offset by Federal subsidy payments to the utility, and that there subsidies will lower his cost of service. This portion of the utility's taxes are by no means phantom or fictitious. They are simply being offset by Federal subsidies.

The phantom tax problem would not arise if the Federal subsidies in question -- the investment credit and accelerated depreciation -- were paid directly in cash grants or as interest-free loans, rather than cleared through the tax system. If the Commerce Department, instead of the Treasury Department, were in the business of providing these subsidies, ratepayers would see that they were being charged the same amount for utility taxes as the utility actually paid in

discharging its liability. Ratepayers would also see a series of checks being written by the Commerce Department to the utilities. Since utility taxes paid to the Treasury would then equal utility taxes paid by ratepayers, the phantom tax issue would have disappeared. And yet, this hypothetical arrangement involving the Commerce Department is the economic equivalent of the system we have today. No one -- not the ratepayers, not the utilities -- is any better or worse off in the hypothetical. Thus, as I said before, the phantom tax problem is one of perception, and not of economics or fairness.

Since this point is essential to understanding the issues before the Subcommittee, let me provide a simple illustration. Suppose a company owes the Treasury $1 million in income taxes, and Congress has decided to pay that company a subsidy of $100,000. Congress could pay the subsidy by having Treasury write a check for $100,000. Alternatively, instead of having the company write a check to Treasury and Treasury write a check to the company, the two payments can be folded together. In effect, this is what happens when subsidies are paid through the tax system. In our example, the company has indeed paid $1 million in tax, and the Treasury has paid $100,000 in subsidies. Of course, an outsider will observe only that a net payment of $900,000 is remitted to the Treasury.

By using the tax system to clear Federal subsidies, we naturally end up with some tax liabilities being less than they otherwise would be. The reduction in tax does <u>not</u> mean that the taxes were never paid. It simply means that two offsetting payments -- a tax payment to the Treasury, and a subsidy payment to the taxpayer -- have cancelled out. The appropriate accounting for subsidies cleared through the tax system is discussed below.

Let me emphasize the important policy lesson contained in the phantom tax issue. We must realize that when the Federal tax system is used for a purpose other than simply raising revenues -- such as for paying capital subsidies -- unexpected and undesirable consequences may follow. In the case before the Subcommittee, the fact that the Federal tax system -- rather than a direct aid system -- is being used to pay capital subsidies to regulated companies is responsible for some ratepayers believing that they are being charged for taxes that the utilities never pay. While there is no economic or financial substance to the ratepayers' view, their annoyance is quite understandable. Moreover, their respect for the basic fairness of the Federal tax system may well be diminished.

The lesson is an important one. When we run subsidies through the Federal tax system, we risk creating significant problems of misperception. These problems may well impinge on the ability of the Federal tax system to function properly, and create problems elsewhere.

How Should Tax Subsidies to Capital be Accounted For?

The next issue is how regulated utilities should account for tax subsidies to capital, such as accelerated depreciation and the investment credit. I would like to offer for the record an analysis of the accounting rules prepared by Treasury, which is attached to my testimony.

Utility regulators have two basic goals: (1) to establish prices that cover the cost of providing utility services, and (2) to minimize the costs of providing those services.

The amount utilities charge for services must be sufficient to cover current expenses such as labor, fuel, and taxes, and the costs of capital used to provide those services. The total costs attributable to the use of capital include depreciation, interest, and a sufficient after-tax return to shareholders to maintain and attract equity capital. The amount charged for utility services must, therefore, be set so that after current expenses, including income taxes, as well as interest and depreciation, shareholders receive an adequate after-tax rate of return.

Consequently, the size of the rate base -- that is, the total capital contributed by lenders and shareholders -- determines all components of the cost of using capital. The rate of return to lenders and shareholders is some "fair return" as a percentage of the rate base. Depreciation represents the fraction of the rate base used up in each year's production.

If part of the rate base is financed by a source other than shareholders and lenders, such as a government subsidy, the charge for utility services should reflect this fact. If the Federal Government provides a 10 percent purchase subsidy with respect to plant and equipment, the rate base should be reduced accordingly, thereby properly recognizing the Federal contributions. By reducing rate base, cost of service elements that are determined by rate base -- both depreciation and fair rate of return -- are also reduced in

proportion to the Federal subsidy. If the government furnishes $10 and private lenders and equity owners provide $90, only $90 has to be regarded as the base for depreciation and a fair rate of return.

The term "normalization" refers to the modifications of utility rate base which reflect the investment credit in the manner I have just described. What this means is that the rate base is reduced by the amount of the subsidy to reflect the fact that private financing is not required for a portion of the assets acquired by the firm. If this is done, the cost of service charged to ratepayers will be precisely the same as if the subsidy had been paid by the Commerce Department in cash. At the same time, the utility's tax expense is the tax liability for the year without reduction for the subsidy. The smaller cash payment to the Treasury is the method by which the government's contribution to the purchase of machinery and equipment has been provided. Section 46(f) of the Code is intended to incorporate this result. For reasons I will explain later, section 46(f) is somewhat deficient.

The analysis for accelerated depreciation is similar to that for the investment credit, except that we are now dealing with interest-free loans rather than cash grants. By providing accelerated tax depreciation to regulated companies, part of the rate base is being financed by interest-free loans from the Treasury. Proceeds of the Treasury loans cannot directly reduce rate base since the loans must be repaid. However, the cost of service is reduced since no rate of return need be paid with respect to the portion of the rate base financed by Treasury's interest-free loans.

Some have suggested that Treasury's interest-free loan is never repaid, that is, the deferred taxes are forever deferred. This is not the case. For any given asset, the loan is repaid as the tax depreciation allowances are reduced in later years of the asset's life. It is true that as new assets are acquired to maintain productive capacity, new loans are extended which, in effect, repay the expiring ones. Thus, a permanent supply of borrowing from the Treasury may be maintained. The "permanency" of the Treasury loan supply is, however, no differnet from the supply of long-term debt provided by private lenders, which is also being replenished on a continuing basis.

The proper accounting treatment for these interest-free loans is also referred to as "normalization". This treatment, which again is consistent with the Congressional intent and with cost of service ratemaking objectives, is the treatment generally required by section 167(l) of the Code.

If a procedure other than normalization is applied to the investment credit or accelerated depreciation, the result will be inconsistent with both the Congressional intent and the objectives of cost of service regulation. If the income tax expense for which ratepayers are charged is reduced by the capital subsidy -- a procedure commonly called "flow-through" -- current ratepayers are being undercharged for their cost of service while future ratepayers will more than make up the difference. Under flow-through, only the current tax expense is reduced. On the other hand, under normalization, all capital costs associated with rate base -- depreciation, interest, taxes, and after-tax returns to stockholders -- may be reduced since the rate base is reduced. These reductions are realized over the life of the asset.

Thus, under flow-through, only the tax expense is reduced. Under flow-through, regulated companies are in effect told that there has been no cost reduction in the qualified property. This plainly defeats the purpose of providing the subsidy in the first place. Likewise, the objective of cost of service ratemaking is defeated since current year customers have cost of service reduced by the full amount of a reduction in capital cost when that reduction should have been spread over the life of the asset for the benefit of future ratepayers.

Let me illustrate these principles with a simple example. A utility buys some machinery with a 30-year life for $30 million. No one would suggest that in the year of acquisition, ratepayers be required to furnish the full $30 million. Instead, assuming straight-line depreciation of the machinery for cost-of-service rate regulation, ratepayers will be charged $1 million per year for depreciation over the life of the machinery, and they will pay a fair rate of return on the undepreciated remainder, financed by lenders and stockholders. Suppose the manufacturer has a "10-percent-off" special. The utility rushes to the store, and the $30 million item instead has a cost of $27 million. No one would suggest that the full amount of the savings be

passed on immediately by reducing current rates by $3 million. What happens instead is that annual depreciation charges are reduced from $1 million to $0.9 million. This has the effect of spreading the benefits of the 10-percent discount to ratepayers over the life of the machinery. Additionally, the fair rate of return charges will be reduced by 10 percent over each year of the asset's life.

The investment credit is no different. The "10-percent discount" provided by the credit should not be flowed-through immediately. Instead, as in the example, the rate base must be adjusted to reflect the fact that assets in the rate base cost 10-percent less. A similar analysis follows for accelerated depreciation except that the tax deferrals -- interest-free loans -- reduce the "finance charge" to lenders and stockholders whose financing is no longer needed.

To summarize then, we must evaluate accounting rules here on the bases of how Congress intended these subsidies to be treated and the objectives of cost-of-service rate-making. Flow-through of the tax subsidies defeats the Congressional objectives by greatly reducing the capital subsidy nature of the provisions.

Should Normalization be Enforced Through the Internal Revenue Code?

At this point, we have told you that the two subsidies in question, accelerated depreciation and the investment credit, should be made available to regulated companies on the same basis as unregulated companies. We have also described how regulators should account for these subsidies. We must next turn to what is the most difficult issue before the Subcommittee -- whether the proper accounting treatment of the subsidies should be enforced through the Internal Revenue Code.

Sections 46(f) and 167(l) do two things. They describe how the subsidies should be accounted for in utility rate-making, and they prescribe penalties for failure to do so. The penalties are quite severe. If the wrong accounting method is chosen, the subsidies are completely disallowed. No middle position is available. It is worthwhile to explore the reasons for imposing such severe penalties.

Initially, the issue involved only accelerated depreciation. Congress first provided accelerated depreciation in the Code in 1954. By the mid- to late 1960's, certain problems had developed with regulated utilities. Some regulators were immediately flowing through the benefits of accelerated depreciation, thereby reducing greatly its capital-subsidy effects. In certain cases, where utilities resisted flow-through, regulators set rates as if flow-through had been elected. At this point, Congress intervened. The Tax Reform Act of 1969 enacted section 167(l) of the Code. These rules provide generally that accelerated depreciation is available to regulated utilities only if normalization is followed for ratemaking purposes. In 1971, when the investment credit was restored, Congress provided the credit to regulated utilities only if a set of rules based upon normalization was followed. These rules are now found in section 46(f) of the Code. The Congressional concern was that absent such rules, regulators would flow-through the credit, thereby defeating its capital subsidy impact.

In the unregulated sector there need be no such concern that company managements may willfully misconstrue a capital purchase subsidy by the accounting procedures they adopt. The management that behaves as if the capital purchase subsidy is a mere reduction in its tax bill will be disciplined by competitors who adopt production and marketing strategies based on the lower cost of production made possible by the subsidy. Regardless of how the subsidy is presented in an unregulated company's financial books of accounts, market prices and output will respond to the real underlying changes in private costs. Prices and costs are equilibrated in unregulated markets independently of accounting formalities. In the regulated sector, on the other hand, the regulatory authorities influence prices and outputs by their interpretation of the rules for cost measurement. By misconstruing the real nature of subsidies cleared through tax accounts, they may misdirect public subsidies.

Further, although flow-through accounting is clearly contrary to the Congressional intent in enacting capital subsidies, it can be extremely attractive. First, it corresponds to the popular misperception that receipts of these subsidies are "phantom taxes". Second, by converting a potential stream of lowered capital charges into a misconstrued reduction in current cost of service, flow-through provides current ratepayers rate reductions that can be quite substantial. In periods of high inflation, there is great impetus to keep rates low currently.

Thus, regulators are subject to intense pressure, both economic and political, to keep rates as low as possible. Under such circumstances, flow-through may be irresistible. In order to offset this pressure, it is suggested, stringent rules such as those found in sections 46(f) and 167(l) are required. Regulators are thereby furnished with the means to counteract pressure to reduce rates currently.

On the other hand, these provisions of the Code no doubt preempt some element of discretion that would otherwise be left to ratemaking authorities. However correct the normalization rules may be, it is argued, they constitute Federal intervention in ratemaking policies. Moreover, since utilities receive enormous quantities of these tax subsidies, ratepayers perceive that they are paying far more for utility taxes than the utilities ever pay. Although, as we have said before, phantom taxes are a problem of perception and not of substance, the perception creates real political problems. Regulators are hard pressed to explain satisfactorily why more taxes are charged for than are actually paid. Furthermore, as some have pointed out, while the tax rules prescribe accounting rules, they do not authorize an inquiry into the motivation for regulators choosing a particular rate of return. This means there are limits as to how far the tax rules can be enforced in the regulatory process.

We cannot be oblivious to the significant problems arising from enforcement of normalization through the Code and from clearing the subsidies through the tax system. If the identical subsidies were provided directly by the Commerce Department in the form of grants and interest-free loans, phantom tax and similar issues would disappear, and the question of whether or not to normalize the subsidies would never arise. Since we believe that (1) normalization is the appropriate accounting technique, (2) the Congressional intent is well served by normalization, and (3) enforcement through the Code has generally been effective, we are constrained to conclude that sections 46(f) and 167(l) are useful and that the policies underlying their enactment continue to have validity.

Administration of Sections 46(f) and 167(l)

The penalties for failure to comply with sections 46(f) and 167(l) are severe. In addition, affected taxpayers are regulated and for the most part, publicly owned. In view of

these constraints, we believe that there has been general compliance with these requirements. In some cases, where utilities have doubts about whether a proposed rate order will comply with the requirements of the Code, they have requested a ruling from the Internal Revenue Service. Due to the severe penalties imposed in the event of noncompliance, we assume that in most cases, these provisions are reasonably self-enforcing.

It is, therefore, not surprising that there have been very few administrative problems involving the IRS. Few ruling requests or requests for technical advice have been received. We understand there are presently two or three normalization issues being considered on audit. No tax liability litigation has as yet involved a normalization issue.

On the other hand, as recent events in California have shown, the current tax rules are not very well equipped to handle controversy. The basic problem is that two different parties, the utility and the regulator, have a say in determining the facts on which the tax subsidies are based. One process -- ratemaking -- exists to handle the relationship between the regulator and the utility. A second process -- tax administration -- exists to handle the relationship between the utility and the IRS. The two processes are independent, and as a result, a problem in one cannot as yet be handled easily in the other.

In view of recent events, we are currently exploring both with regulators and utilities whether a separate tax proceeding can be devised to resolve quickly any questions involving sections 46(f) and 167(l). We hope to know soon whether a satisfactory procedure can be developed.

A Technical Problem With Section 46(f)

The accounting rules prescribed for the investment credit in section 46(f) do not adequately reflect the principles of normalization and cost of service ratemaking. Since we believe that if any rules are to be enforced, they should be normalization rules, we would like to discuss with you the problems with section 46(f) and how these problems should be remedied.

1. Section 46(f)(1). This section provides that the credit shall not be allowed if

"... the taxpayer's cost of service for ratemaking purposes is reduced by reason of any portion of the credit allowable ... or

> "... the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by reason of any portion of the credit allowable ... [unless] the reduction in rate base is restored not less rapidly than ratably."

Current investment credit rules permit taxpayers to claim depreciation for the portion of the asset financed by the credit. Section 46(f)(1) is ambiguous because it does not provide guidance as to how to account for depreciation attributable to the portion of the asset financed by the investment credit.

The correct set of rules should provide that (1) tax expense in any year may not be reduced by the allowable investment credit or by the tax savings from depreciation attributable to the portion of the asset financed by the investment credit, and (2) the rate base used for both depreciation charge computation and to which the fair rate of return is applied must be reduced by the allowable investment credit and by the tax savings from depreciation attributable to the portion of the asset financed by the investment credit.

2. Section 46(f)(2). Here, an alternative procedure is prescribed. The cost of service may be reduced by no more than a ratable portion of the allowable credit over the life of the asset. But the rate base may not be reduced "by reason of any portion" of the credit. In effect, the depreciation charge is reduced in recognition of the government capital purchase subsidy, but ratepayers are expected to pay stockholders the entire fair rate of return on the government's contribution to the rate base assets.

Not surprisingly, utilities elect section 46(f)(2), for it seems to ensure them of a greater than fair rate of return on their own funds.

We believe that section 46(f)(1) should be rewritten to reflect more accurately the correct accounting procedure for normalization of the investment credit. In addition, we believe that section 46(f)(2) should be deleted, since it does not accurately reflect normalization accounting procedures.

Should an Excise Tax be Substituted for the Income Tax on Utilities?

In response to controversies involving phantom taxes and flow-through, it has occasionally been suggested that these issues be resolved by substituting an excise tax on utility services for the corporate income tax now levied on utilities. We believe that any such change in the law would be a serious mistake.

We believe that the motivation for such proposals is misplaced. As we discussed before, the only reason utility taxes actually paid vary so much from utility taxes that ratepayers are charged for is that capital subsidies are being cleared through the Federal tax system, and utilities use enormous amounts of capital. Once this is recognized, there is no further reason for suggesting that an excise tax be substituted for the income tax on utilities.

In addition, we would note the following:

- Sound principles of public finance policy disfavor specific excise taxes except for (1) control purposes, and (2) overcoming "market failure", as in the case of an excise tax serving as a substitute for price controls, and pollution taxes, which internalize externalities.

- The proposal implies that an excise tax may, in fact, be substituted for an income tax. This is not true. An excise tax is, in effect, imposed on all inputs: labor, materials, and services provided by other firms, as well as capital. An income tax falls on earnings only.

- Either an _ad valorem_ or a specific excise tax would impose widely varying tax burdens on consumers. An _ad valorem_ tax would penalize consumers of high cost companies dependent on expensive fuel or burdened by high local taxes. A specific excise tax would penalize consumers served by low-cost companies, largely comprised of publicly-owned entities.

- Most public utilities do more than sell electric energy. Construction and supply of gas services are common. As a result, segregation of exempt income from taxable income will be an administrative nightmare.

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STATEMENT OF THE HONORABLE ROGER C. ALTMAN
ASSISTANT SECRETARY OF THE TREASURY
FOR DOMESTIC FINANCE
BEFORE THE STATE, JUSTICE, COMMERCE, THE JUDICIARY AND
RELATED AGENCIES SUBCOMMITTEE
OF THE HOUSE APPROPRIATIONS COMMITTEE

Mr. Chairman and Members of the Committee:

My testimony will discuss the Administration's request for two appropriations relating to the Chrysler Loan Guarantee Program: first, a full one-time appropriation enabling the Chrysler Corporation Loan Guarantee Board to make payments of principal and interest on any guaranteed loan in default; and, second, an appropriation to cover the Fiscal Year 1981 administrative expenses of implementing the Guarantee Act.

On April 8, the Guarantee Board submitted its report to Congress for the period through March 31, as required by Section 14 of the Guarantee Act. A copy of the report is attached. This testimony will not specifically review developments through that date, since covered by that report.

A One-Time Full Appropriation

Mr. Chairman, the Administration requests a one-time appropriation through December 31, 1991, of such sums as are necessary to make payments of principal and interest, if there is a default, on the $1.5 billion principal amount of loans which are authorized to be guaranteed. As you know, all guaranteed loans must mature by December 31, 1990. However, the appropriated sums should remain available until December 31, 1991, to provide extra time for resolution of any dispute or litigation over a payment due in 1990.

Mr. Chairman, when I appeared before this Committee last December, the Administration sought an appropriation with two elements:

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- A one-time authorization permitting the Guarantee Board to issue guarantees of the principal and interest on the loans for the benefit of Chrysler for the full $1.5 billion principal amount authorized by the Guarantee Act, plus such additional amounts as may be necessary to pay interest which may be in default; and

- A one-time appropriation of such sums as are necessary to make payments of principal and interest, if there is a default, on all of the loans which could be guaranteed.

The Congress provided the first element, but not the second. The Appropriation Act (PL 96-183) passed by Congress on January 2, 1980, authorized the issuance of guarantees, but only committed to make the necessary appropriations to make payment under the guarantees.

Cost and Marketing Factors

In December, I testified that providing the latter appropriations would be necessary to assure that the financing plan could be assembled. Chrysler's financial advisors, Salomon Brothers, and its special counsel, Debevoise, Plimpton, Lyons & Gates have further investigated the marketing issues and confirmed the concerns that I voiced in December: without the appropriation, both the unguaranteed and guaranteed financing will be troublesome or significantly more costly to Chrysler.

Guaranteed Assistance

A guarantee which is not backed by a one-time full appropriation may result in unnecessary added financing costs for Chrysler. Specifically, lenders will seek an additional interest premium on guaranteed loans, since payment on a default could be delayed due to the need for congressional action to appropriate sums for payment. Such increased interest charges would increase the financial liability of the Federal Government on its guarantees. Furthermore, to the extent that a guarantee fee is negotiated which involves a share of profits, the increased interest cost will reduce the fees to the Federal Government.

Chrysler's financial advisors believe that this interest premium attributable to the lack of appropriation could approximate two full percentage points (200 basis points) over a comparable three-year issue of Treasury securities. A copy of their letter is appended to this testimony, together with Chrysler's. This means that Chrysler could incur $90 million of additional interest expense over three years on the full $1.5 billion of guarantees.

Treasury generally agrees that Chrysler would incur much higher interest costs, although we have made no specific estimate. Chrysler's advisors also indicate that the guaranteed loans may be difficult to sell without the appropriation under the market conditions that it projects for this summer. Indeed, initially Salomon Brothers hoped to sell guaranteed securities with maturities approximating 6 months. Because of the lack of appropriations to pay the guaranteed securities, they are now recommending maturities of one to two years.

Furthermore, it also would be difficult to obtain the necessary long-term unguaranteed financing commitments unless clear-cut Federal guarantees were available. This was our experience in other guarantee programs of this nature, such as New York City. To the extent questions are raised concerning the ability to sell guaranteed securities, the success of these negotiations may be impaired.

The Need for a Full $1.5 Billion Appropriation

Mr. Chairman, I request that the Congress appropriate sums to make payment on the full $1.5 billion of principal and relevant amounts of interest, to be made available beginning immediately through 1991, because Chrysler may ultimately draw down the full amount of authorized guarantees. The company's latest projections indicate less than full usage, but those projections are being revised substantially.

Timing

Mr. Chairman, an Appropriation Act is necessary immediately to help assure that the Congressional aims of the Guarantee Act are satisfied.

Specifically, Chrysler's cash flow outlook indicates that the overall guaranteed and unguaranteed financing plan must be implemented within the short-term. Also, most guaranteed loans will be needed during this fiscal year and the early part of 1981, although no payments will be made under the guarantees during this fiscal year because the guaranteed loans are not expected to mature until later.

Mr. Chairman, Chrysler and those with an economic stake in its future have made progress in meeting the requirements of the Guarantee Act. Chyrsler has revised its operating plan and has developed a related financing plan. Significant progress has been made toward assembling the long-term unguaranteed financing which is a condition required for Federal guarantees:

° Chrysler and its unions have entered into a revised labor contract to provide $462.5 million in required wage concessions. Chrysler also has adopted a plan to obtain $125 million in wage concessions from its non-union employees.

° State and local governments have been moving forward with legislation and other programs to provide the $250 million of financing which the statute requires of them.

° Chrysler is now soliciting its dealers and suppliers to purchase at least $230 million in subordinated debentures. Commitments for part have been received and additional commitments are expected this month.

° Chrysler has entered into a tentative agreement with its domestic and some foreign lenders toward the $650 million in contributions and concessions required from them in addition to extensions of amounts committed as of October 17, 1979.

° Chrysler has identified assets to be sold to meet the $300 million target for proceeds from asset dispositions and has entered into related negotiations.

Furthermore, Chrysler is negotiating with the Canadian Government and others for financing that might bring the total package to more than the $1.43 billion.

Mr. Chairman, it would be indeed unfortunate if after all this effort and progress, this rescue effort were to fail or be significantly frustrated by a relatively technical issue such as this appropriation question.

Administrative Expenses

Mr. Chairman, the Administration also requests an appropriation for Fiscal Year 1981 of approximately $1.3 million, including funding for 20 permanent positions to enable the Board to administer the loan guarantee program established by the Guarantee Act. As you know, our approach to this program is to seek appropriations for administrative expenses only on an annual basis.

These funds and positions are necessary to maintain the Office of Chrysler Finance and related support activities in the Treasury Department. The Loan Guarantee Board requires staff assistance and other services to satisfy its responsibilities under the Act. Those responsibilities include nego-

tiations over the guaranteed and unguaranteed portions of Chrysler's four-year financing plan; the continuing analysis of Chrysler's four-year operating plan, its financing plan, and other plans necessary for the Board to make the determinations required by the Act in order to issue guarantees; and preparation of annual reports to Congress concerning its activities. These responsibilities will continue throughout the entire period that guarantee commitments and guaranteed loans are outstanding. The expertise necessary will continue to require contractual services from experts in the private sector. Specifically, we have employed the public accounting and management consulting firm of Ernst & Whinney to help us analyze and evaluate Chrysler's current status and its operating and financial plans. We have also hired the law firm of Cahill Gordon & Rheindel to help us prepare the legal documents and review legal issues incident to the financing transaction, including security arrangements.

Our appropriation for these administrative purposes for Fiscal Year 1980 was approximately $1.5 million and 20 permanent positions. To date, we have filled approximately one-half of these positions. In the meantime, we have relied significantly on outside experts, with approximately $1 million of the $1.5 million budgeted for their fees. Our reliance on outside experts should diminish after we make our initial determinations and complete any financing agreements.

That diminution, however, will produce additional staff responsibilities. Thus, for 1981, approximately $600 thousand is budgeted for consultants, and $500 thousand for internal staffing with the remainder for incidental expenditures.

Of the internal positions, 14 are professionals: 11 financial analysts, and three attorneys. Of the analysts, one slot is held by the Office Director, and the remaining ten are divided equally among individuals responsible for Chrysler's operating plan and among those responsible for its financing plans and ongoing finances. The remaining slots are for clerical personnel.

I would be pleased to answer any questions.

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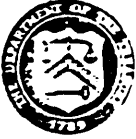

THE SECRETARY OF THE TREASURY
WASHINGTON 20220

April 8, 1980

Dear Bill:

Enclosed is the Chrysler Corporation Loan Guarantee Board's report to Congress for the period through March 31, 1980, as required by Section 14 of the Chrysler Corporation Loan Guarantee Act of 1979. It does not cover developments since that date.

Sincerely,

Bill

G. William Miller

The Honorable
William Proxmire
Chairman
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, D.C. 20510

Enclosure

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Enclosure

March 31, 1980

CHRYSLER CORPORATION LOAN GUARANTEE BOARD

REPORT TO CONGRESS FOR THE PERIOD THROUGH MARCH 31, 1980

INTRODUCTION

Section 14(a) of the "Chrysler Corporation Loan Guarantee Act of 1979" (the "Act") requires the Chrysler Corporation Loan Guarantee Board to report on its activities to the Congress semiannually in fiscal years 1980 and 1981, and annually every fiscal year thereafter in which there are outstanding guaranteed loans or commitments issued by the Board. This, the first of the Board's reports, covers the period from enactment on January 7 through March 31, 1980.

This report is divided into four sections: first, how the Board is organized to implement the Act; second, Chrysler Corporation's current operational and financial condition; third, Chrysler's efforts to comply with the nonfinancing provisions of the Act; and fourth, the company's efforts to assemble the $1.43 billion in sales of assets and in unguaranteed private financing assistance from its constituents before the Board can provide Chrysler Federal guarantees.

Chrysler has made considerable progress since the Act was passed, but the seriousness of its situation is not to be underestimated. It has developed improved operating and financing plans, and has moved forward toward meeting the Act's requirements for unguaranteed financing assistance.

THE TERMS OF THE ACT

The Guarantee Act established a five-member Board to implement its terms. The Board is comprised of three voting members, and two ex officio non-voting members. The voting members are the Secretary of the Treasury, as Chairperson, the Comptroller General of the United States and the Chairman of the Board of Governors of the Federal Reserve System. The non-voting members are the Secretary of Labor and the Secretary of Transportation.

The Act authorizes the Board to guarantee up to $1.5 billion principal amount of loans (plus interest thereon) for the benefit of the Chrysler Corporation only if certain conditions are met. Among the more significant pre-conditions, the Board must determine that:

- Chrysler's operating plan demonstrates that the company can continue as a going concern through 1983 with the guarantee program and, also, that it can continue to do so thereafter without additional Federal assistance, and that these plans are reasonable and feasible.

- The company's financing plan meets the needs of the operating plan, and is reasonable and feasible. This plan must include at least $1.43 billion required proceeds from sales of assets and in unguaranteed financing assistance. The Act establishes targets for domestic and foreign creditors, State and local governments, and suppliers, dealers, and others with a stake in the future of the company, although the Board may modify compliance with specific targets. There must also be firm commitments or adequate assurance that all required proceeds from sale of assets and unguaranteed financing have been or will be received to meet the aggregate goals set by the statute.

March 31, 1980

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- The labor unions that represent Chrysler's employees have agreed to provide $462.5 million in wage concessions for the period September 14, 1979 to September 14, 1982; and Chrysler has adopted a program for achieving at least $125 million concessions from its nonunionized employees.
- The collateral received by the Government for its guarantees, together with Chrysler's prospective earning power, furnish reasonable assurance of repayment of the guaranteed loans.
- Employee stock ownership is provided through establishment of an employee stock ownership plan. Also, $100 million of stock must be made available for purchase by employees and their unions.

Other requirements include adoption of an energy savings plan and a productivity improvement plan. These are discussed below.

ACTIVITIES OF THE GUARANTEE BOARD

The Board began its formal efforts to implement the Act shortly after the Act was signed on January 7, 1980. Since January, the members of the Board, as well as their senior staff, have devoted substantial time and effort to implementation of the Act.

The Board has held five meetings to date. Its members have met with Chrysler Board Chairman Iacocca, members of his senior management, and his outside advisors, as well as with representatives of certain of the constituents required to participate in the unguaranteed long-term financing.

The Board has relied primarily on staff support provided by the Treasury Department. To organize the various activities, the Board appointed a General Counsel and an Executive Director/Secretary, both from the Treasury. In addition, to assure maximum coordination between the voting members of the Board, senior staff from the

General Accounting Office and the Federal Reserve System have been detailed to work full time with the Board's staff. Additional staff work, including the analysis, documentation, and recommendations for Board actions, is provided by Treasury's Office of Chrysler Finance. Also aiding the analytical effort are the private consultants who worked with the Administration last fall: the public accounting/management consulting firm of Ernst & Whinney, and John C. Secrest, a former financial vice president of American Motors Corporation. The Board has also engaged the New York City law firm of Cahill Gordon & Reindel to assist on legal matters. The Board's staff has met on a weekly basis with Chrysler in both Washington and Detroit, and is in constant communication with them.

CHRYSLER'S RECENT OPERATIONS AND CURRENT SITUATION

In the past year Chrysler experienced financial difficulties. The passage of the Act offered the company and its constituents access to additional financial resources thereby alleviating some of the pressures on the company. The expectation of Federal assistance has enabled Chrysler to obtain interim private financing assistance to continue its operations while developing the operating and financing plans and assembling the unguaranteed financing needed to meet the other terms of the Act, as illustrated below:

- $100 million in interim financing from a short-term loan from PSA/Peugeot-Citroen, conditioned on receipt of an option to purchase Chrysler's stock interest in Peugeot in the event a long-term relationship between the two companies is not negotiated.

- $146 million in additional financing of imports from Mitsubishi Motors Company.
- $175 million from deferral of January, February and March supplier and vendor payments into April, May, and June respectively.

These measures more than offset the cash flow impact of projected first quarter losses and, by mid-February, Chrysler indicated that it might continue to operate for quite some time without drawing down significant Federal assistance.

Chrysler currently estimates its 1980 losses could be between $550 million and $650 million. Sales of domestically-produced Chrysler vehicles, in line with the sales of most domestically produced vehicles, have been below forecast. Recent sharp increases in interest rates, reduced credit availability, and uncertainty over the state of the economy have further complicated the situation by impairing prospects for future sales while increasing Chrysler's and its dealers' operating and financing costs. Additional interim financing may therefore soon be necessary.

PROGRESS IN MEETING THE REQUIREMENTS OF THE ACT

Before addressing Chrysler's operating and financing plans, the progress made by Chrysler and others to meet the numerous requirements of the Act will be reviewed.

Report Requirements

The Act requires certain agencies to submit reports on specific subjects. The Board's staff began meeting with each agency in early January to coordinate the efforts of each, and assure timely completion of those relevant to the determinations required from the Board. These have been satisfied or are progressing:

- Small Business Administration Study. The Act requires the Small Business Administration (SBA) to study the financial problems faced by small business automobile dealers, determine what assistance through Federal loans and loan guarantees may be needed and can be made available to alleviate such problems, and to report on the study to the Congress within 60 days.

  SBA submitted its report to the Congress and the Board on March 7, 1980. It describes the overall decline of all dealerships, with a substantial increase in closings in 1979 offsetting an increase in the number of import car dealers. Financial problems are attributable to the reduction in domestic car sales and price increases, and the high cost of financing dealer inventory. The report emphasizes that while guaranteed term loans could be made to dealers, their financial problems could only be solved by a reduction in the inflation rate and the increased availability from domestic producers of the types of fuel efficient cars desired by consumers.

  The report indicates that the financial problems are more acute for Chrysler dealers, due to Chrysler's problems and their relatively fewer sales per dealer.

- Department of Transportation Study. The Act requires the Department of Transportation (DOT) to conduct a six-month study of the auto industry, and Chrysler's viability in it, and the impacts on regions of the country of various energy and economic assumptions. The Act requires that the report be submitted to Congress by July 7, 1980 -- within 180 days after enactment. The Board's staff has worked closely with DOT and expects an interim report in early April and a full draft report by late April or early May. DOT is coordinating its efforts closely with those of the Board's staff, which has made its consultants' analyses available to DOT.

- EPA Regulations. The Act requires the Environmental Protection Agency (EPA) to promulgate within 60 days of enactment regulations on the inclusion of electric vehicles in the CAFE requirements. The Department of Energy is then to conduct a seven-year evaluation of the proposed inclusion. EPA provided a preliminary draft to the Board staff on March 17, and intends to promulgate the regulations in draft during April. These regulations are apt to have no impact on Chrysler during the foreseeable future.

Requirements of Chrysler

The Act imposes four additional requirements on Chrysler as follows:

Energy Savings Plan

A draft Energy Efficiency Plan was submitted by Chrysler to the Board's staff in early February. Comments were obtained from other interested agencies -- EPA, DOT, NHTSA and the Department of Energy -- and were provided to Chrysler which revised its plan in response to those comments. A revised plan was submitted to the Board on March 7. The Board is currently studying this plan in connection with its review of Chrysler's operating and financing plans.

The key elements of the Chrysler plan, which indicates that the company will reduce total fleet lifetime petroleum consumption by 89,500,000 barrels in the 1985 model year, compared with its 1974 products, follows:

- Major product changes that will increase the efficiency of its vehicles and, thus, reduce energy consumption. Some of these are discussed below in greater depth in the context of Chrysler's operating plan and product program.
  - Autos: Reduced vehicle weight and engine size, so as to improve fuel efficiency by 5 miles per gallon for the 1979 to 1980 period and projected to increase it by an additional 5 miles per gallon by 1985. From

1974-1985, the company's fleet fuel efficiency will have risen 89%, with a 34% improvement taking place during the 1980-1985 period. Federal regulatory requirements are planned to be met throughout.

- Trucks: Instituted similar programs, which increase its fuel efficiency approximately 25% over the 1980-1985 period. Federal regulatory requirements are not projected to be met in two of the five years, because of the lead time necessary while the company develops new smaller truck lines.

- Manufacturing facility changes to reduce fuel consumption, by conversion from oil to other fuels and increased efficiency for all plants.

Productivity Improvement Plan

The Act requires Chrysler to submit, as part of its operating plan, a productivity improvement plan detailing actions to increase its productivity. Chrysler submitted such a plan to the Board on March 4. The Board has the plan currently under review.

The plan projects a 21.3 percent improvement in total productivity by 1983 over 1979 measured by reference to labor hours. This increase results primarily from manufacturing process improvements and fixed manpower reductions, and includes both labor and nonlabor related improvements.

Employee Stock Ownership Plan

The Act requires Chrysler to adopt an employee stock ownership plan into which it is to deposit $162.5 million in Chrysler common stock under specified provisions. This stock is to be provided in consideration of the wage concessions agreed to by the company's employees.

Chrysler provided a revised draft plan to the Board which it developed after consultation with its unionized employees and Board staff. On March 19, Chrysler submitted the plan to the Internal Revenue Service for review. The Board has not yet determined whether the present ESOP proposal satisfies the Act.

THE OPERATING PLAN

Since the Act was passed, Chrysler has undertaken a substantial revision of its long-term product plans. On February 25, it submitted to the Board a new "Preliminary Operating Plan" which projects a 1980 loss of approximately $500 million and a return to profitability in 1981. In addition, the company has reorganized and strengthened its management and retained management consultants and financial advisors to assist it in developing its operating and financing plans. It has also obtained the agreement of its unions to provide the concessions required by the Act, and has adopted a plan to obtain the required concessions from non-union employees.

The revised operating plan reflects major changes and improvements from the plan prepared in October. The salient points of the revised plan follow:

- Acceleration of the introduction of new small fuel-efficient cars and trucks. By model year 1985, the company will produce and sell only smaller front-wheel drive cars and trucks which will be predominantly powered by four-cylinder engines.

- Introduction of the first of the plan's new vehicles, the K-car, is scheduled for this coming fall. It is a four-cylinder front-wheel drive fuel-efficient automobile. The company's viability in the coming years depends on its success in building and selling the K-car at a profit.

- A reduction in the number of distinct vehicle lines from last year's level. The company's automobile platforms will drop from five to three. Large trucks will be dropped from the company's vehicle offering and replaced with small fuel-efficient trucks based upon the new car platforms.

- Increased commonality of parts from the reduction in the number of platforms, which will reduce the number of distinct major components, such as engines and transaxles, resulting in improved efficiency and servicability.

- Fixed costs will be held nearly to the 1979 level, while the volume of production is increasing.

- Variable costs over the base year will be reduced by $2.2 billion on the company's vehicles. Actions to be taken include a general tightening of control by management in such areas as equipment changes, design cost reductions, development of components internally and streamlined purchasing practices.

- Reductions in fixed and variable costs will lower the company's breakeven level of production, thus increasing profit potential and reducing the company's vulnerability to economic and market fluctuations.

- Capital spending in the 1979 to 1985 period will be reduced by almost $1 billion from the level assumed last fall to $12.6 billion. Most of the savings will be realized in 1984 and 1985.

- Management control and information systems have been improved to assure implementation of planned programs and to permit the company to anticipate problems and react to them in a timely manner.

In our view, the revised operating plan represents a first step for Chrysler's return to long-term commercial viability. The Board's staff has not yet completed a final evaluation of the plan, nor has it reached any final conclusions. However, preliminary indications are that substantial adjustments to the plan may be necessary.

- The plan's projected 1980 loss of approximately $500 million appears too low in light of the company's first quarter performance. Chrysler currently estimates that its loss for the year could be

between $550 million and $650 million. To date this year, Chrysler's market share has been substantially below forecast, although total sales have been higher than forecast because of a larger total market.

- The company's estimate of the size of the auto market for later years of the plan may be too optimistic. Chrysler's plan forecasts total U.S. car sales for 1981 and 1982 at 11.0 million and 12.1 million units, respectively. In contrast, the median forecast of Data Resources, Chase Econometrics, and Wharton is 9.9 million and 10.6 million units respectively.
- The company expects to be able to increase the wholesale prices of its new small fuel-efficient vehicles faster than the rate of inflation for all years covered by the plan.
- Chrysler's goal is to attain improvements in variable margin resulting in a very large increase in gross margins by 1983.
- The plan projects constant fixed costs in real terms for the company despite major increases in planned volumes.
- The plan assumes that continued erosion in the size of its dealer network will have no effect on the company's sales results, despite the reduced market coverage.

Lower profits in the plan years would increase the financing needs of the company in general and the demand for Federally guaranteed assistance, in particular. Each dollar of reduced profit in the near term approximately will result in a dollar of increased financing need for Chrysler if it is to continue its present product development programs.

At the request of the Board's staff, Chrysler and its consultants have identified alternative measures which the company could implement to reduce the financing needs if there were a deterioration in operations from the plan projections. Once the

Guarantee Board has completed its analysis of the current operating plan and its contingency plan, it will be in a better position to assess whether some or all of those alternative actions should be included in the basic plan.

FINANCING PLAN

Chrysler has also submitted a Preliminary Financing Plan, dated February 27, 1980, to meet the financing needs generated by its Operating Plan and which details the company's strategy for raising these funds. The Operating Plan projects that the company will require cumulative funding peaking at $2.3 billion in 1982, which declines to $700 million by 1985. To this need the Financing Plan adds $177 million of Canadian capital expenditures which are not in the Operating Plan and $1.0 billion of financing contingency reserves which grow to $2.3 billion by 1985. As Chrysler's plans have developed over the past six months, its assumptions have been altered. As a result, the potential financing need of $3.0 billion which was cited in the Administration's November testimony is not directly comparable to the figures in the new plan.

The Preliminary Financing Plan projects financing through 1983 of approximately $3.5 billion to meet the adjusted operating cash need and the $1 billion financing contingency. The financing plan provides five basic parts:

- $1.689 billion from the long-term financing package that Chrysler proposes to meet the requirements of the Guarantee Act for constituent contributions and concessions and the proceeds of the sales of assets.

- $429 million from additional pension fund payment deferrals.
- $716 million through 1983 for its foreign operations: $646 million from the Canadian Government and $70 million for its Mexican operations. (The Plan projects an additional $25 million in loans from Canada in 1984.)
- $677 million in preexisting debt that was scheduled to mature or be renewed in 1980, but which must continue in place under the terms of the Act.
- Federal guaranteed loans of only $200 million on a temporary basis during the second and third quarters of 1980. Since these loans are projected to be repaid by yearend 1980, the funds are not reflected in the $3.5 billion total. The company asserts the need for the full $1.5 billion in commitments to provide a reserve against the risks inherent in its operating and financing plans.

In light of the risks to achieving planned projections, the potential need for Federal assistance is significantly underestimated. The Board's staff is still analyzing the plan and has not reached judgments at this time because of the uncertain status of the current negotiations to achieve the company's long-term financing plan and the need for further review of its operating plan.

Unguaranteed Financing Sources

The Preliminary Financing Plan submitted on February 27 proposes to raise the unguaranteed funds in a manner somewhat different from the statutory objectives. As a result, the company has indicated it will ask the Board to modify the statutory targets among types and sources of funds for the $1.43 billion total from sales of assets and unguaranteed financing assistance. Under the Act, the Board has the authority to make appropriate modifications. A comparison of the targets set by the statute and the sources proposed by Chrysler follows:

Nonfederal Financing Assistance
Constituent Contributions and Concessions
($ millions)

	Guarantee Act Targets	Chrysler 2/27 Plan	Difference
State, local and other governments*	$ 250	$ 299	$ 49
Suppliers and dealers			
Contributions & concessions	130	230	100
Capital investments	50	0	(50)
Additional equity	50	0	(50)
Asset dispositions	300	510	210
Banks and other financial institutions			
Domestic Creditors:			
-- New credits (extended maturities and deferred interest)	400	209	(191)
-- Concessions	100	122	22
Foreign creditors:			
-- New credits (extended maturities and deferred interest)	150	209	
-- Concessions	--	110	169
Total	$1,430	$1,689	$ 259

As discussed below, the current status of negotiations does not provide a basis for determining whether the plan will be achieved and would be consistent with the statutory requirements.

State, Local and Other Governments

The Act calls for at least $250 million in assistance from State, local and other governments. While significant progress has

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* Canadian Government assistance is not yet sufficiently assured to be included here.

been made in some States, the company has not yet received any funds and is still in the process of obtaining firm commitments for much of the package. Most of this financing will be at market rates and partially or fully collateralized by some of Chrysler's best assets, thus reducing substantially the risk to these lenders. Waivers are required from certain of Chrysler's lenders in order to permit the pledging of assets to secure the loans by State and local governments. The Appendix describes the status of Chrysler's efforts in each jurisdiction at the date of this report.

Suppliers and Dealers

Chrysler proposes to sell subordinated debentures to meet the Act's target for at least $180 million of financing assistance from suppliers, dealers and others with a stake in its future. The company has filed a prospectus with the SEC and is offering for sale $400 million of these securities. It began soliciting purchase orders on March 12 and expects to complete the offering in April. All subscriptions are subject to confirmation after the Board has issued its commitment. A substantial portion of the proceeds may be received in monthly installment payments over two years. Chrysler projects proceeds of at least $230 million from this source and has proposed that the Board accept the $100 million of such proceeds as satisfying the targets in the Act for capital and the sale of new equity described below. As of March 31, Chrysler reported that it had conditional subscriptions or indications of interest for approximately $65 million from its dealers and suppliers toward the $230 million goal.

The Act requires that at least $50 million of the $180 milli be in the form of "capital", which the Act defines to include fun on which no interest or dividends are paid so long as guaranteed loans are outstanding. The debentures, however, do not meet the capital definition because they are to bear interest at 12 percen Chrysler's investment bankers state that the company is unable to obtain noninterest, nondividend bearing funds from its dealers, suppliers, and others at this time, and thus Chrysler proposes that the Board modify the target for capital.

Equity

The Act, as indicated, calls for an additional $50 million in new equity investments by nonfederal sources, but does not permit the payment of dividends on Chrysler securities while guarantees are outstanding. Chrysler's advisors believe that it is not possi ble to sell nondividend bearing equity. Therefore, the company proposes that the Board waive this requirement, and substitute $50 million of the $230 million in subordinated debentures include in its plan.

Asset Dispositions

The Act calls for at least $300 million in proceeds from asset dispositions. Chrysler's plan envisions sales that would result in proceeds of $510 million:

	$ million
Chrysler Financial Corporation (51%)	$320
Foreign subsidiaries of CFC	14
Foreign subsidiaries of parent	45
Real estate	31
Nonrecourse term loan from Peugeot secured by Chrysler's common stock in Peugeot	100
Total	$510

Although a portion of the items may not be counted toward the target because the proceeds would not pass to the parent company, this $510 million component is well in excess of the statutory goal. Chrysler proposes that the excess be counted against the shortfalls described below for creditor assistance.

Chrysler has sold or entered sales agreements for approximately $150 million, including the secured loan from Peugeot. For the rest, it appears that Chrysler will not have firm commitments and will propose that the Board accept letters of intent or corporate resolutions as evidence of assurance that the proposed sale will occur.

Among those sales for which firm agreements are not in place is the principal asset to be sold: Chrysler Financial Corporation, (CFC), the company's wholly owned financing subsidiary. In the past, Chrysler's domestic bank lenders have stated that the sale of 51 percent of CFC or a restructuring of its financing is a precondition for their participation in the financing plan to insulate CFC and the subsidiary's creditors from the financial problems of the parent and a potential lien in favor of the Pension Benefit Guarantee Corporation for the parent's unfunded pension fund liabilities.

Banks and Other Financial Institutions

The Act calls for at least $650 million from existing lenders and creditors: $500 million from domestic creditors, of which $400 million is to be in new credits and contributions and $100 million in concessions; and $150 million from foreign creditors.

The statute requires these amounts to be in excess of loan commitments outstanding on October 17, 1979.

Chrysler has not received commitments from any financial institutions to meet these targets, but it is actively negotiating with its creditors. The current negotiations suggest several issues which will need to be resolved:

- Allocation among the lenders. Chrysler's domestic lenders have indicated that they will not provide the full $500 million themselves. They have proposed that all lenders participate in the $650 million on a basis proportionate to the loans which were actually outstanding on October 17, 1979.

- Form of Bank Participation. Chrysler's plan has not proposed, and the banks have thus far declined to provide, additional cash. Instead, their assistance would be limited to interest concessions and deferral of interest and principal payments.

- Chrysler Financial Corporation. The domestic banks have been conditioning their participation on the sale of 51 percent of Chrysler Financial Corporation or a restructuring of its financing for the reasons previously stated. Neither the sale nor the restructuring has been negotiated. As a result, it may be difficult to obtain adequate assurance of the banks' contributions until this sale or restructuring is near consummation. Furthermore, any sale or restructuring of CFC will likely involve continuing obligations of Chrysler to CFC. Thus, the overall contribution by the lenders must be evaluated in conjunction with arrangements negotiated for the CFC sale or restructuring.

- Preexisting commitments and loans. The Act effectively provides that only amounts in excess of commitments outstanding on October 17, 1979, are to be considered in meeting the targets of the Act. Chrysler's October plan indicated that, on that date, there were $245 million more available in foreign and domestic loans and loan commitments than are now available: $159 million in unused commitments under the domestic revolving credit; $8 million in credits from other domestic banks; $68 million under a revolving credit with Canadian banks; and $10 million in credits to Chrysler Canada Leasing by other Canadian banks.

The domestic banks' position, as reported to the Guarantee Board, has been that they would not provide the $159 million since Chrysler could not meet the conditions of the commitments on October 17. Thus, they have stated that effectively there was no commitment.

Chrysler's financing plan assumes the domestic commitment would be replaced by $159 million in proceeds from asset sales in excess of the Act's target. It assumes that the Canadian shortfall would be met by a $68 million line of backup credit which may be guaranteed by the Canadian Government and may not be used. It also states that the $8 million short-fall in domestic bank lines should not be included, since erroneously included as outstanding in the October 17 plan.

The question of timing in completing an acceptable financing agreement with the domestic banks is the keystone of Chrysler's financing program. The European and Japanese creditors are both reportedly waiting for a decision by the domestic banks before they reach a decision on their own participation. The Canadians are also waiting for that decision, as well as for a decision by the Canadian Government.

Other Financing

Other aspects of the plan also raise significant issues that the Board is now addressing:

Canada. Chrysler's plan assumes $671 million in assistance from Canada: $500 million in loan guarantees and $171 million in grants. Chrysler has not proposed to count any of this against the targets of the Act because of the uncertain timing of commitment and receipt. The Canadian Government has made no decision on providing assistance, but its Minister for Industry, Trade and Commerce has publicly stated that any aid offered to Chrysler probably would be less than requested in the plan.

Mexico. The financing plan assumes the receipt in 1980 of a $70 million term loan to meet the requirements of its Mexican engine plant. The company is currently seeking

guarantees from the Export-Import Bank. It has not, however, proposed that this loan be counted against the targets because it is not assured. If not received, Mexican investments may have to be met from the parent company's other financing sources, unless financed in Mexico.

Import financing. Several issues are raised by Chrysler's financing transactions with a syndicate of Japanese banks and Mitsubishi Motors Corporation (MMC) to finance the company's import of vehicles from MMC. On October 17, 1979, Chrysler had commitments from the Japanese banks for $400 million in import financing using 180-day letters of credit. The Japanese banks terminated the credit agreement; approximately $156 million presently remains outstanding, down from $168 million. Completion of the financing package will require resolution of the pending issues between Chrysler, MMC and the Japanese banks. Chrysler is considering other financing means which would essentially be on a fully secured basis.

Security

The Act requires the Board to require security for the loans to be guaranteed at the time the commitment to guarantee is made. At the time a guarantee is actually issued, the Act requires the Board as a condition of issuance to determine that the prospective earning power of the company, together with the character and value of the security pledged, provide reasonable assurance of the repayment of the loan to be guaranteed.

The Board is currently pursuing the security package in order to obtain collateral adequate to meet all reasonable risks on the potential commitment and to achieve the intent of the priority for the guaranteed loans created by the Act. Chrysler's approach to date has been to offer $1 in security for every $1 in guarantees as such guarantees are issued.

Attachment

Summary of Other Governmental Assistance
From Eight States and One City
(Dollars in millions)

LOCATION	TYPE OF CREDIT	STATUS
Michigan:	$150 secured loan $5 property sale	- legislation enacted - terms under negotiation
Detroit:	$29 lease with purchase option	- dependent on Federal grant - initial application was denied; but terms are under negotiation
Indiana:	$32 secured loan from bank insurance fund	-legislation enacted -legal issues raised by State attorney general that may frustrate proposal
Missouri:	$25 secured loan	-legislation required; new proposal under negotiation
Illinois:	$20 guaranteed loan	-legislation introduced
Ohio:	$14 sale/leaseback $6 property sale	-legislation required; new proposal under negotiation
New York:	$10 secured loan	-initial proposal denied; new proposal under negotiation
Delaware:	$5 secured loan	-legislation enacted -terms under negotiation
Alabama:	$3 loan guarantees	-initial proposal denied; new proposal under negotiation
Total	$299	

Members of the New York Stock Exchange, Inc.

One New York Plaza
New York, N.Y. 10004 (212) 747-7000

Salomon Brothers

February 15, 1980

Chrysler Corporation
Loan Guarantee Board
Room 3000
15th and Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Gentlemen:

On behalf of Chrysler Corporation, for whom we are acting as financial advisor, we hereby recommend that the Chrysler Corporation Loan Guarantee Board (the "Board") take the necessary steps to obtain the specific appropriation of such funds as may be required for the payment of principal and interest on up to $1,500,000,000 aggregate principal amount of loans guaranteed under the Chrysler Corporation Loan Guarantee Act of 1979 (the "Act"). Such funds should remain available at least until some reasonable period after December 31, 1990, the final authorized date for maturity of a guaranteed loan.

It is our judgment that the absence of specific appropriation of such funds would have an extremely adverse impact on the marketing of debt to be guaranteed by the Board, and also with respect to the pricing of such debt.

Accordingly, we strongly recommend that the specific appropriation be made prior to any issuance of debt to be guaranteed by the Board.

Very truly yours,

SALOMON BROTHERS

CHRYSLER
CORPORATION

March 3, 1980

Chrysler Corporation Loan
  Guarantee Board
c/o Treasury Department
15th and Pennsylvania Avenue, N.W.
Washington, D.C. 20020

Attention: Mr. Brian M. Freeman
  Executive Director
  and Secretary

Specific Appropriation under
Chrysler Corporation Loan
Guarantee Act of 1979

Dear Sirs:

By letter dated February 15, 1980, Salamon Brothers, our financial advisor, recommended that the Chrysler Corporation Loan Guarantee Board take the necessary steps now to obtain the specific appropriation of such funds as may be required for the payment of principal and interest on up to $1,500,000,000 aggregate principal amount of loans guaranteed under the Chrysler Corporation Loan Guarantee Act of 1979.

At a meeting held today at the office of the General Counsel of the Department of the Treasury further discussions concerning the necessity for specific appropriation of funds were held. In addition to the General Counsel and one of his staff, representatives of Salomon Brothers, Debevoise, Plimpton, Lyons & Gates, Patton Boggs & Blow and Brown, Wood, Ivey, Mitchell & Petty participated in the discussions.

Based on today's discussion, and on advice from its legal and financial consultants, Chrysler hereby requests the Board to proceed as swiftly as possible to obtain specific appropriation of funds. The supplemental appropriation language pending before Congress (a copy of which is attached hereto) is satisfactory to us.

Please let us know if any further information is required or if Chrysler or any of its advisors can be of further help in the legislative process by which the specific appropriation we have requested will be obtained.

Sincerely yours,

Robert S. Miller, Jr.
Assistant Controller

Department of the Treasury

BUREAU OF GOVERNMENT FINANCIAL OPERATIONS

CHRYSLER CORPORATION LOAN GUARANTEE PROGRAM

(Supplemental appropriation language request pending)

There are appropriated such sums as may be necessary for payment of principal and interest on loans guaranteed pursuant to the Chrysler Corporation Loan Guarantee Act of 1979 and in default, to be available immediately and to remain available until December 31, 1991.

This supplemental appropriation language is pending before the Congress. This language is needed for the implementation and administration of the Chrysler Corporation loan guarantee program.

Department of the TREASURY

WASHINGTON, D.C. 20220 **TELEPHONE 566-2041**

NEWS

FOR IMMEDIATE RELEASE
April 15, 1980

CONTACT: GEORGE G. ROSS
(202) 566-2356

TREASURY ISSUES SEVENTH DISC ANNUAL REPORT

The Treasury Department today released its seventh Annual Report on the "Operation and Effect of the Domestic International Sales Corporation Legislation" (DISC). This report covers income tax returns for DISCs with accounting periods ending between July 1, 1977 and June 30, 1978, referred to as DISC year 1978.

Highlights of the Report are:

--The revenue cost to the Treasury was $730 million for DISC year 1978, compared to $750 million for DISC year 1977. This decline represents a continuation of the substantial drop in revenue cost between DISC years 1976 and 1977 reflecting the curtailment in DISC benefits required by the Tax Reform Act of 1976. DISC year 1978 was the first year in which all DISCs were affected by the provisions of the 1976 Act.

--Total U.S. exports are estimated to have been $3.6 billion higher in DISC year 1978 than they would have been without the DISC program. This is approximately $300 million lower than the amount by which exports in DISC year 1977 (July 1, 1976 to June 30, 1977) exceeded the level that would have prevailed without the DISC program.

The report suggests that the effect of the DISC legislation was largely a one-time increase in exports, occurring mostly between 1972 and 1975, followed by movement along a new higher trend line. The drop in exports induced by DISC in 1978 appears to be largely a random fluctuation. However, a portion of the decline may have resulted from the provisions of the Tax Reform Act of 1976, under which the DISC benefits are calculated on the basis of increases in exports over a base period level rather than on total DISC exports.

The DISC report examines foreign export tax practices, the Multilateral Trade Negotiations (MTN) Subsidies/Countervailing Measures Agreement, and the General Agreement on Tariffs and Trade (GATT) prohibition against rebating corporate income and

other direct taxes to exporters. Because direct tax burdens are generally higher in foreign countries than they are in the United States, the report notes that allowing all countries to rebate direct taxes to exporters would have the initial effect of worsening the U.S. competitive position.

Copies of the seventh DISC Annual Report are available for purchase from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20401. When ordering, use Stock No. 048-004-01721-1.

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artment of the TREASURY NEWS
INGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. April 15, 1980

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $7,000 million, to be issued April 24, 1980. As the regular 13-week and 26-week bill maturities were issued in the amount of $6,384 million, this offering will provide the Treasury about $600 million new cash above the amount maturing through the regular issues. The two cash management bill issues, totaling $5,005 million, maturing April 24, consisting of $2,004 million of 167-day bills issued November 9, 1979, and $3,001 million of 143-day bills issued December 3, 1979, will be redeemed at maturity.

The $6,384 million of regular maturities includes $1,401 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,714 million currently held by Federal Reserve Banks for their own account. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,500 million, representing an additional amount of bills dated January 24, 1980, and to mature July 24, 1980 (CUSIP No. 912793 4X 1), originally issued in the amount of $3,247 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,500 million to be dated April 24, 1980, and to mature October 23, 1980 (CUSIP No. 912793 5L 6).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing April 24, 1980. Tenders from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities will be accepted at the weighted average prices of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents of foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Monday, April 21, 1980. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held at the close of business on the day prior to the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering; e.g., bills with three months to maturity previously offered as six month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $500,000 or less without stated price from any one bidder will be accepted in full at the weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on April 24, 1980, in cash or other immediately available funds or in Treasury bills maturing April 24, 1980. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

M - 432 Missing

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE ON DELIVERY
EXPECTED AT 9:00 a.m.
April 16, 1980

STATEMENT OF THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE SENATE COMMITTEE ON FINANCE

Mr. Chairman and Members of the Committee:

My purpose here today is to advise you of the Treasury's financing needs through fiscal year 1981 and to request an increase in the authority to issue long-term securities in the market and removal of the statutory interest rate ceiling on savings bonds.

Financing Requirements

The present temporary debt limit of $879 billion will expire on May 31, 1980, and the debt limit will then revert to the permanent ceiling of $400 billion. Prompt enactment of legislation is necessary to permit the Treasury to borrow to refund maturing securities and to pay the Government's other legal obligations.

Our current estimates of the amounts of debt subject to limit at the end of each month through the fiscal years 1980 and 1981 are shown in the attached table. The table indicates that the debt subject to limit will increase to $881 billion on September 30, 1980, and to $897 billion on September 30, 1981, assuming a $15 billion

M-433

cash balance on these dates. These estimates are consistent with the Administration's March revision in the budget estimates. The usual $3 billion margin for contingencies would raise these amounts to $884 billion in September 1980, and $900 billion in September 1981. Thus, the present debt limit of $879 billion should be increased by $5 billion to meet our financing requirements through the remainder of fiscal 1980 and by an additional $16 billion to meet the requirements through fiscal 1981. However, as indicated in the table, the debt subject to limit reaches a seasonal peak in May 1981 of $914 billion and then declines to $897 billion in September, assuming a constant $15 billion cash balance. Thus, we are requesting that the debt limit for FY 1981 be increased to $910 billion, which would get us by the temporary May 29 peak with an adequate cash balance of $11 billion on that date.

For your convenience, the deficit and debt figures for each year over the past decade are shown in the final table attached to my statement.

Let me emphasize the importance of timely Congressional action on the debt limit. In mid-May the Treasury expects to announce offerings of new note issues to refund obligations which mature on May 31 and perhaps to raise new cash. Since May 31 is a Saturday the obligations maturing on May 31 cannot be paid off or refunded until Monday, June 2, at which time the present debt limit authority will have expired. Moreover, we will also need to announce and auction Treasury bill issues in the third or fourth week

of May. These do not settle until the first week of June. Thus, without an increase in the debt limit by mid-May, we will be forced to postpone offerings because delivery of the securities in early June could not be assured. Failure to offer these securities as scheduled could be disruptive of the Government securities market and costly to the Treasury.

Investors as well as dealers in Government securities base their day-to-day investment and market strategies on the expectation that the Treasury will offer and issue the new securities on schedule. Delayed action by Congress on the debt limit, therefore, would add to market uncertainties, and any such additional risk to investors is generally reflected in lower bids in the Treasury's auctions and consequently in higher costs to the taxpayer.

This Committee has made every effort in the past to assure timely action by Congress to increase the debt limit. Yet, the record of recent years has not been good. On three of the last five debt limit bills action was not taken before the expiration date, and the Treasury was unable to borrow until the Congress acted two or three days later. Significant costs were incurred by the Treasury, and extraordinary measures were required to prevent the Government from going into default. The Treasury was required to suspend the sale of United States savings bonds, and people who depend upon social security checks and other Government payments suddenly realized that the Treasury simply could not pay the Government's bills unless it was authorized to borrow the funds needed to finance the spending programs previously enacted by Congress.

It is essential that we do everything possible to maintain the confidence of the American people in their Government. Confidence in the management of the Government's finances was seriously undermined each time the debt limit was allowed to lapse, and we must all work to avoid that outcome in this instance.

Bond Authority

I would like to turn now to our need for an increase in the Treasury's authority to issue long-term securities in the market without regard to the 4-1/4 percent ceiling.

Under this Administration, the Treasury has emphasized debt extension as a primary objective of debt management, a policy which we believe to be fundamentally sound. This policy has caused a significant increase in the average maturity of the debt, reversing a prolonged slide which extended over more than 10 years. In mid-1965 the average maturity of the privately-held marketable debt was 5 years, 9 months. By January 1976 it had declined to 2 years, 5 months, because large amounts of new cash were raised in the bill market and in short-term coupon securities. Since that time, despite the continuing needs for cash of the Federal Government, Treasury has succeeded in lengthening the debt to 3 years, 10 months, currently.

Debt extension has been accomplished primarily through continued offerings of long-term bonds in our mid-quarterly refundings as well as regular offerings of 15-year bonds in the first month of each quarter. By developing the long-term sector of the market we have broadened the market and increased

demand for Treasury securities. These longer-term security offerings have also contributed to a more balanced maturity structure of the debt, which will facilitate efficient debt management in the future. Moreover, these offerings have complemented anti-inflation efforts. By meeting some of the Government's new cash requirements in the bond market rather than the bill market, we have avoided adding to the liquidity of the economy at a time when excessive liquidity is being transmitted into increasing prices.

Congress has increased the Treasury's authority to issue long-term securities without regard to the 4-1/4 percent ceiling a number of times in recent years, and in the debt limit act of September 29, 1979, it was increased from $40 billion to the current level of $50 billion. To meet our requirements for the remainder of the fiscal year 1980, the limit should be increased to $54 billion; and to meet our requirements in the fiscal year 1981, the limit should be increased to $70 billion.

The Treasury to date has used over $45 billion of the $50 billion authority, which leaves the amount of unused authority at less than $5 billion. While the timing and amounts of future bond issues will depend on prevailing market conditions, a $20 billion increase in the bond authority would permit the Treasury to continue its recent pattern of bond issues throughout fiscal year 1981. We are currently issuing long-term securities at an annualized rate of approximately $14 billion.

Savings Bonds

In recent years, Treasury has recommended frequently that Congress repeal the ceiling on the rate of interest that the Treasury may pay on U.S. Savings Bonds. In the debt limit Act of April 2, 1979, Congress increased the statutory ceiling from 6 percent to 7 percent. The Treasury increased the savings bond rate to 6-1/2 percent effective June 1, 1979. Then, in December 1979, the Treasury announced that the interest rate on the new 11-year series EE bonds, which went on sale on January 1, 1980, would be 7 percent for bonds held to maturity and that the rate on outstanding E bonds would also be increased to 7 percent for bonds held an additional 11 years. Legislation is necessary to provide for further increases beyond the present 7 percent statutory ceiling.

Mr. Chairman, we are concerned that the present requirement for legislation to cover each increase in the savings bond rate does not provide sufficient flexibility to adjust the rate in response to changing market conditions. The delays encountered in the legislative process could result in serious inequities to savings bond purchasers and holders as interest rates rise on competing forms of savings.

The Treasury relies on the savings bond program as an important and relatively stable source of long-term funds. On that basis, we are concerned that participants in the payroll savings plans and other savings bond purchasers might drop out of the program if the interest rate were not maintained at a level reasonably competitive with comparable forms of savings.

While the savings bond rate has increased relative to the 5-1/2 percent regulatory ceiling on passbook savings in Federally-insured thrift institutions, the much greater increase in market interest rates over the past year has had a substantial adverse impact on the savings bond program.

Sales of savings bonds in 1978 reached $8 billion, a peacetime record; but in 1979, as market interest rates increased, savings bonds sales fell to $7 billion. In the first three months of 1980 sales were only $1.4 billion, 26 percent below the first quarter in 1979 and 34 percent lower than sales in the first quarter of 1978.

The major problem, however, has been on the redemption side. In 1979 savings bonds redemptions were $12.3 billion, compared to $8.2 billion in 1978, an increase of 50 percent. Redemptions in the first quarter of 1980 were $6.4 billion, double the amount in the first three months of 1979 and more than three times the redemptions in the first quarter of 1978.

Consequently, the cash loss to the Treasury from the excess of redemptions over sales in the savings bond program was $5.3 billion in 1979, and was $5.0 billion in just the first three months of 1980. These cash losses to the Treasury must be made up by increasing the amounts the Treasury borrows in the market, and the Treasury is currently paying significantly higher interest rates on its market borrowings. If this situation continues, it will be essential to increase the savings bond interest rate

ESTIMATED PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1980
Based on: Budget Receipts of $532 Billion,
Budget Outlays of $569 Billion,
Unified Budget Deficit of $37 Billion,
Off-Budget Outlays of $15 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1979		ACTUAL	
September 28	$24.2	$828	
October 31	10.5	828	
November 30	5.6	835	
December 31	15.9	846	
1980			
January 31	16.6	849	
February 29	10.7	856	
March 31	8.2	865	
		ESTIMATED	
April 30	15.0	872	875
May 30	15.0	885	888
June 30	15.0	874	877
July 31	15.0	879	881
August 29	15.0	885	888
September 30	15.0	881	884

ESTIMATED PUBLIC DEBT
SUBJECT TO LIMITATION
FISCAL YEAR 1981
Based on: Budget Receipts of $628 Billion,
Budget Outlays of $612 Billion,
Unified Budget Surplus of $16 Billion,
Off-Budget Outlays of $19 Billion

($ Billions)

	Operating Cash Balance	Public Debt Subject to Limit	With $3 Billion Margin for Contingencies
1980			
October 31	$15	$891	$894
November 30	15	898	901
December 31	15	898	901
1981			
January 30	15	894	897
February 27	15	902	905
March 31	15	911	914
April 30	15	912	915
May 29	15	914	917
June 30	15	907	910
July 31	15	903	906
August 31	15	904	907
September 30	15	897	900

Federal Deficits and Debt, 1970-81
(in billions of dollars)

Fiscal Years	1970	1971	1972	1973	1974	1975	1976	TQ	1977	1978	1979	1980e	1981e
funds deficit	13.1	29.9	29.3	25.6	18.7	52.5	68.9	11.0	54.5	61.5	46.1	50.1	-2.4
Trust fund surplus (-) or deficit	-10.3	-6.8	-5.9	-10.7	-14.0	-7.4	-2.4	2.0	-9.5	-12.7	-18.3	-13.6	-14.1
Total unified budget deficit	2.8	23.0	23.4	14.8	4.7	45.2	66.4	13.0	45.0	48.8	27.7	36.5	-16.5
Deficit of off-budget Federal entities 1/	-	-	-	.1	1.4	8.1	7.3	1.8	8.7	10.3	12.4	15.0	18.7
Total deficit	2.8	23.0	23.4	14.9	6.1	53.1	73.7	14.7	53.7	59.2	40.2	51.5	2.2
Nonborrowing means of financing 2/	2.6	-3.6	-3.9	4.4	-3.1	-2.4	9.2	3.3	-.1	-.1	-6.5	-12.2	-.7
Total borrowing from the public	5.4	19.4	19.4	19.3	3.0	50.9	82.9	18.0	53.5	59.1	33.6	39.3	1.5
Change in debt held by Government agencies 3/	10.1	7.4	8.4	11.8	14.8	7.0	4.3	-3.5	9.2	12.2	19.7	13.6	14.1
Change in gross Federal debt	15.5	26.9	27.9	31.1	17.8	57.9	87.3	14.5	62.7	71.3	53.3	52.9	15.6
Less: Change in Federal agency debt	1.7	.3	1.3	-.2	-.9	1.1	-	-.2	1.4	1.4	1.6	.5	.6
Equals: Change in gross public debt	17.2	27.2	29.1	30.9	16.9	59.0	87.2	14.3	64.1	72.7	54.9	53.4	16.2
Plus: Change in other debt subject to limit 4/	-.7	-1.2	-	-.4	-	.1	.1	-	-	-	-	-	-
Equals: Change in debt subject to limit	16.5	26.0	29.1	30.5	16.9	59.0	87.3	14.3	64.1	72.7	54.9	53.4	16.1
Debt Outstanding end of FY													
Gross Federal debt 5/	382.6	409.5	437.3	468.4	486.2	544.1	631.9	646.4	709.1	780.4	833.8	886.6	902.3
Less: Federal agency debt 5/	12.5	12.2	10.9	11.1	12.0	10.9	11.4	11.7	10.3	8.9	7.2	6.7	6.1
Equals: Gross public debt	370.1	397.3	426.4	457.3	474.2	533.2	620.4	634.7	698.8	771.5	826.5	880.0	896.1
Plus: Other debt subject to limit 4/	2.5	1.3	1.3	.9	.9	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.0
Equals: Debt subject to limit	372.6	398.6	427.8	458.3	475.2	534.2	621.6	635.8	700.0	772.7	827.6	881.0	897.1

Office of the Secretary of the Treasury, Office of Government Financing

April 15, 1980

1/ Consists largely of Federal Financing Bank borrowings to finance off-budget programs.
2/ Largely reflects changes in the Treasury cash balance.
3/ Consists largely of trust fund surplus or deficit.
4/ Net of certain public debt not subject to limit.
5/ Fiscal year 1976 figure includes reclassification of $471 million of Export-Import Bank certificates of beneficial interest from asset sales to debt.

Source: Special Analysis E, U.S. Budget

e = estimate

promptly in order to avoid further substantial cash drains to the Treasury and permanent damage to the savings bond program. The amount of any necessary rate increase will depend on current market conditions and on the other terms and conditions offered to savings bonds investors. We are currently reviewing the savings bonds program to determine what changes need to be made. Thus, we are requesting that the present ceiling on the savings bond interest rate be repealed as soon as possible.

Any increase in the savings bond interest rate by the Treasury would continue to be subject to the provision in existing law which requires approval of the President. Also, the Treasury would, of course, give very careful consideration to the effect of any increase in the savings bond interest rate on the flow of savings to banks and thrift institutions.

Debt Limit Process

I would now like to comment on the process by which the public debt limit is established.

Separate legislation for a statutory debt limit has not been an effective way for Congress to control the debt. The increase in the debt each year is simply the result of earlier decisions by Congress on the amounts of Federal spending and taxation. Consequently, the only way to control the debt is through firm control over the Federal budget. In this regard, the Congressional Budget Act of 1974 greatly improved Congressional budget procedures

and provided a more effective means of controlling the debt. That Act requires Congressional concurrent resolutions on the appropriate levels of budget outlays, receipts, and public debt. This new budget process thus assures that Congress will face up each year to the public debt consequences of its decisions on taxes and expenditures.

The debt limit act of September 29, 1979, which established the current limit of $879 billion, also amended the rules of the House of Representatives to tie the establishment of the debt limit to the Congressional budget process. Under the new House rules, the Treasury still presents its debt limit requests in testimony before the House Ways and Means Committee, and that Committee makes its debt limit recommendations to the House Budget Committee. Yet, the vote by which the House adopts a budget resolution will be deemed to be a vote in favor of a joint resolution changing the statutory debt limit to the amount specified in the budget resolution. The joint resolution on the debt limit will then be transmitted to the Senate for further legislative action. No comparable procedure exists in the Senate. The Senate must still vote twice on the debt limit figure, in the budget resolution and in the separate debt limit bill. Thus, it is essential that your Committee act promptly to assure timely action by Congress on the debt limit.

Attachments

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partment of the TREASURY

NEWS

HINGTON, D.C. 20220 TELEPHONE 566-2041

For Release Upon Delivery
Expected at 10:00 a.m. EST

STATEMENT OF DONALD C. LUBICK,
ASSISTANT SECRETARY OF THE TREASURY (TAX POLICY)
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
APRIL 16, 1980

Introduction

President Carter's Fiscal Year 1981 Budget included a recommendation to extend the Airport and Airway Trust Fund (Trust Fund) and the air user taxes from 1980 to 1990. In order to obtain a contribution from general (noncommercial) aviation more in line with the amount of Federal air expenditures that cost allocation studies of the Federal Aviation Administration (FAA) attribute to general aviation, the President also recommended changing the 7 cents per gallon tax on fuel used by noncommercial aviation to a 10 percent ad valorem tax and the imposition of two new taxes of 6 percent on retail sales of planes and avionics for domestic noncommercial aviation use. These recommendations are incorporated in H.R. 3745, introduced by Mr. Johnson of California.

While the taxes on commercial aviation and their customers are estimated to represent 90 percent or more of the airway costs allocated thereto, the ratio for general aviation is only 14 to 22 percent, depending on the assumption used. The proposed tax increases would raise the percentage significantly.

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Purpose of the Trust Fund

Additional taxation of general aviation is consonant with the intent of the Congress to assure an equitable distribution of airport and airway costs among users as reflected in Section 209 of the Airport and Airway Revenue Act of 1970. This Act directed the Secretary of Transportation to conduct a study and investigation "to make available to the Congress information on the basis of which it may determine what revisions, if any, of the taxes imposed by the United States should be made in order to assure, insofar as practicable, an equitable distribution of the tax burden among the various classes of persons using the airports and airways of the United States or otherwise deriving benefits from such airports and airways."

Because the Airport and Airway Trust Fund is estimated to have an uncommitted balance of $3.5 billion as of the beginning of fiscal year 1981, some have proposed reducing the passenger ticket tax from 8 percent to 2 percent. Evaluation of such a proposal requires a review of the function of the Trust Fund as it was envisioned by this Committee when it voted to establish the Trust Fund in 1970.

In the report of this Committee (H.R. Rep. No. 91-601) on the 1970 Act, it is stated that "The Ways and Means Committee agreed that users of the Federal aviation system should properly pay for a greater share of the cost than at present, and that the goal should be for the civil part of the system to eventually become self-sustaining from air user taxes."

Since it was intended that the air user taxes reflect Federal aviation costs represented by civilian use, the Trust Fund could not fully finance the Federal aviation system without additional revenues representing the costs of the system considered attributable to military usage. In addition, it was estimated that the 1970 user taxes would not generate enough revenues from civil users to cover costs attributable thereto for some years to come. Accordingly, Section 208(d) of the law establishing the Trust Fund authorized the appropriation to the Trust Fund of "such additional sums as may be required to make the expenditures referred to in subsection (f) of the section."

In addition to grants for airport development, this subsection listed expenditures of the FAA "which are attributable to planning, research and development, construction, or operation and maintenance of -

(i) air traffic control,
(ii) air navigation,
(iii) communications, or
(iv) supporting services,

for the airway system".

Operation, and maintenance of the airway system is the largest element in Federal expenditures for aviation, and the 1970 law recognized them as an essential part of the airway system that users should pay for. The operation of the airway system is the cornerstone of our air system, for without the air controllers and communication personnel airports and hardware lose their value. At the same time, these functions are costly, for they are labor intensive.

Unfortunately, as a result of concern about the administration of the airport grant system during the first year after the 1970 legislation, the functions which could be financed by the Trust Fund were changed by Public Law 92-174, enacted on November 27, 1971 to eliminate costs of operation and maintenance for the airway system. Since that time, some revisions have been made to reinstate certain costs associated with equipment and its maintenance, but the large element of airway operation remains outside the scope of the Trust Fund.

The result of the 1971 amendment has been twofold. With the exclusion of a major cost element, the Trust Fund has accumulated a large surplus. At the same time, much of the civil portion of airway costs has had to be financed by taxpayers in general rather than by airway users as was originally intended.

The growth of the balance in the Trust Fund has led some to conclude that airway users, particularly air passengers, are being taxed more than is required to offset Federal expenditures for their direct benefit. The suggestion to reduce the air ticket tax follows from this incorrect conclusion.

Actually, the way to achieve an integrated and coherent air user financing system is to follow the principle the Congress originally enacted and finance airway operations and maintenance from the air user taxes supporting the Trust Fund with any necessary appropriation from general fund revenues to cover military usage.

The Administration Proposal

President Carter's recommendations move in this direction through increases in the funding of airway operation and maintenance from the Trust Fund. I need not go into these expenditure details as they are better explained by the Department of Transportation, but I do want to emphasize that we believe civil airway user taxes should finance the services that the Federal government provides airway users just as Federal highway aid is financed from highway users.

President Carter's March 14 recommendation for an additional tax on gasoline of 10 cents per gallon (14 cents in total) at current price levels requires reconsideration of his aviation fuel tax recommendation for a 10 percent ad valorem tax on fuel for noncommercial aviation. At the present time, we understand that a 14 cents tax and 10 percent tax on aviation fuel would be relatively equal. But, if at any time, the 10 percent tax were to be greater or less than the specific tax, which should prevail? If aviation user taxes are to continue, they must be reenacted before the end of June. In view of the time factor, we recommend that the aviation fuel proposal be considered in and of itself at this time. However, when the President's fuel tax proposal is considered, the aviation fuel tax should be integrated with it, so that the higher of the tax under the President's proposal or the instant aviation fuel tax would be used. All of the revenue from whichever tax rate were in effect would be transferred to the Airport and Airway Trust Fund, provided that the Trust Fund is again used to meet FAA's operation and maintenance expenses attributable to civilian use of the airways.

Lastly,there are some technical adjustments in present taxes that the Committee might want to consider that are discussed in the appendix to my statement.

Conclusion

Congress originally intended that airway user taxes should finance the services that the Federal Government provides civilian airway users just as Federal highway aid is financed from highway users. To this end, costs of operation and maintenance attributable to civilian use should be funded from the Trust Fund, not general revenues as is now largely the case. The President's proposals offer a means of accomplishing this objective.

APPENDIX

Comments on Technical Changes

1. Terminal handling charges

The report of the Senate Finance Committee on the 1970 legislation stated that charges for accessorial services are subject to the transportation of property tax "if such service can only be provided by the airline and if the charge for the service is applicable to all using it." It also added that exemption from tax required that the accessorial charge be separately stated. The Treasury Department has ruled on the tax status of a number of such services. In particular, it held that the Post Office Department was liable for tax on terminal handling charges under a contract to carry mail whereby two separate rates were quoted, a line haul charge, and a terminal handling charge. The latter covered such services as receipt of the mail at the terminal, transfer between planes, and loading and unloading planes. When the Post Office objected to the ruling, it was decided to get an opinion from the Department of Justice. The latter Department upheld the objection of the Post Office Department and the Treasury reversed its earlier position in Rev. Rul. 80-53.

We wish to recommend that the law be amended to specifically include terminal handling charges of the type covered by the Post Office contract within the scope of the tax on transportation of property by air. Other customers of the airlines pay a single element rate which includes line haul and terminal handling services.

2. Exemptions from air user taxes

When the air user taxes were enacted in 1970, the Congress decided that the purpose of the legislation necessitated removal of the exemptions for domestic flights which the then existing taxes contained. For instance, unlike the general excise tax rules, State and local governments were not exempted from the taxes on passenger tickets, transportation of property, or the aircraft use tax. However, the law continued the exemption from the tax on fuel used in noncommercial aviation by State and local governments, private nonprofit schools, and farming. Subsequently, exemption from the fuel and aircraft use tax was extended to aircraft museums.

We believe it would be consistent with the purpose of these taxes, to repeal the exemptions.

3. Suggestions by Air Transportation Association

The Air Transport Association (ATA) has asked us to consider five changes in the present air user taxes. Our position are as follows:

a. Trips to Alaska and Hawaii and between Alaska and Hawaii

These trips are now subject to the 8 percent tax on the mileage of the trip in the United States plus the $3 international departure tax. The ATA recommended simplifying the work of determining the tax for each ticket by elimination of the present rules and substitution of a flat 4 percent tax on trips between the continental United States and Alaska or Hawaii, and a 2 1/2 percent tax on trips between Alaska and Hawaii.

We have no objection to a simplified system provided it results in relatively rough justice to travelers from different parts of the continental United States to Alaska and Hawaii. The ATA is reviewing the fare structure to determine whether a single flat rate would be fair to most travelers. Perhaps a zone system might be warranted.

b. Trips to Canada or Mexico and the 225 Mile Zone

Passenger tickets purchased in the United States are subject to the 8 percent tax if the trip begins in the United States or the area in Canada and Mexico within 225 miles of the United States border and ends in the United States or the 225-mile zone. As a result, trips entirely within Canada or Mexico are taxable. In addition, Canada levies an 8 percent tax, with a maximum tax of $10, on trips from Canadian airports even though the ticket may have been taxed in the United States. The ATA recommends that all trips to Canada and Mexico be treated as other foreign trips and made subject only to the $3 per head international departure tax.

We believe that we should not act unilaterally. Some agreement needs to be reached first with the Canadian government.

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Department of the TREASURY NEWS
IINGTON, D.C. 20220 TELEPHONE 566-2041

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STATEMENT OF THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON INTERGOVERNMENTAL
RELATIONS AND HUMAN RESOURCES
HOUSE COMMITTEE ON GOVERNMENT OPERATIONS

Mr. Chairman and Members of this distinguished Subcommittee:

My purpose today is to discuss the President's proposal for a new Revenue Sharing Program. The proposed bill, the "Local Government Fiscal Assistance Amendments of 1980," was submitted to Congress yesterday. It expresses the President's commitment to the principle of general fiscal assistance.

The current Revenue Sharing Program is funded through fiscal 1980 at an annual rate of $6.9 billion. Since the Program was enacted in 1972, one-third of the payments have been allocated to State governments and two-thirds to localities. The need for a balanced 1981 budget has caused the President to propose that, in the future, no Revenue Sharing payments be made to States. The future Program would involve, therefore, only payments to local governments. These would be made at the rate of $4.6 billion annually, which is unchanged from the present level.

As you know, inflation has accelerated during the past two months and the Administration has redoubled its efforts to reduce it. A central element in this strengthened anti-inflation program is a revised 1981 budget--one that is balanced. To achieve that balance, the Administration has reduced its originally proposed 1981 outlays by $17.2 billion. It was necessary to eliminate funding for Revenue Sharing payments to State governments as part of this outlay-reduction effort. The need to cut Federal spending to reduce inflation must take precedence.

Revenue Sharing payments represent about 1.1 percent of the total general revenues of State governments. The States have a far greater ability than localities to absorb a loss

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of this magnitude, given both their current financial condition and their legal capabilities to adjust revenues and expenditures.

However, the loss by State governments of $2.3 billion per year in Revenue Sharing payments is likely to force them to cut back their own payments of aid to local governments. To assist localities, especially those experiencing the most fiscal stress, in adjusting to the reduced amounts of State aid, the President is proposing that an additional $500 million in transitional assistance be paid to local governments in fiscal years 1981 and 1982. The likely magnitude of the impending losses in State aid to fiscally weak local governments makes such transitional assistance imperative.

Why Revenue Sharing?

Concerning our recommendations on the new Program, let me put them in perspective by reviewing the history of Federal Revenue Sharing. The Program was first enacted in 1972 to redress a "fiscal mismatch." Federal taxes were perceived to be more equitable and responsive to economic growth than the taxes levied by State and local governments. At the same time, it was believed that the demands for State and local government services were rising more rapidly than the demands for the services provided by the Federal government.

Many changes have taken place since 1972. It is no longer true that State and local--and particularly State--revenue systems are inferior. They have made major strides in broadening and refining their tax systems so that they are more equitable and more responsive to economic change.

At the same time, it is no longer clear that expenditure demands rise most rapidly at the State and local level. For instance, while the pressure for increasing education expenditures at the State and local level has eased, the aging of our population presents the Federal government with rapidly escalating outlays for social security and medical care.

Because of these changes, the underlying rationale for Revenue Sharing must be reconsidered, and the Program adapted to a different set of circumstances. A "fiscal mismatch" remains the overriding problem. But the mismatch is quite different from the one addressed by the original Program.

Today the primary fiscal problem of the American federal system is the imbalance between resources and responsibilities at the local level. Many local governments in our nation have responsibilities for providing public services that are disproportionate to the fiscal resources to which they have access.

The objective of the new Revenue Sharing Program must be to ensure the access of every general-purpose local government to fiscal resources in reasonable proportion to its responsibilities for providing public services.

Fiscal imbalances are due in part to the workings of our economy. In some cases, the resources of local governments are inadequate because their economies are declining or lagging behind growth in the rest of the nation as industry shifts to other areas. This problem plagues many areas of the Northeast and upper Midwest. In other cases, resources are inadequate because the locality's economy is underdeveloped. This problem is especially acute in the South and in many rural areas throughout the nation. Neither of these reasons for inadequate fiscal resources is easily overcome by local initiatives, or even by State action. Revenue Sharing is essential to enable localities whose economies are weak to provide adequate levels of public services.

Our proposals are designed to relieve the fiscal problems of the most acutely stressed local governments. This will be accomplished by improving the targeting of Revenue Sharing payments to local governments making an above-average tax effort and whose residents have below-average incomes. With Revenue Sharing relieving the most serious disparities, the States will be able to devote their energies and resources to addressing the underlying structural sources of local fiscal problems. Treasury will be monitoring the extent to which the Revenue Sharing Program continues to assist State governments to fulfill their responsibilities for solving local fiscal problems.

Better Targeting of Revenue Sharing

The heart of the Revenue Sharing Program is the formula that allocates funds to over 39,000 local jurisdictions. This formula is generally sound. However, our analysis over the past two years has established that a number of modifications are necessary to ensure that the distribution of funds makes a consistent contribution to the reduction of disparities in local fiscal capacities. We are proposing specifically that:

1. Current procedures for distributing funds among States remain unchanged. These procedures allocate resources in accordance with general patterns of need and are based on carefully wrought compromises between a host of legitimate political interests. However, the $500 million in transitional assistance in fiscal years 1981 and 1982 will be allocated in proportion to the current amount of aid provided by each State to its general-purpose local governments.

2. The essential logic of the intrastate distribution formula is valid and should be maintained. However, the formula should be adjusted so that higher levels of funding are directed toward full-service jurisdictions whose residents have comparatively lower incomes and bear high tax burdens.

3. The allocation procedure of the intrastate distribution should be modified so that jurisdictions of comparable size with the same incomes and tax efforts receive the same Revenue Sharing payments.

4. No formula modification should violate the fundamental principle that virtually every general-purpose local government in the nation should participate in the Program.

These recommendations, although modest, will significantly improve the tone of the Revenue Sharing Program. They are based on discussions with experts in intergovernmental fiscal issues throughout the country and officials at all levels of government, a year-long review by the Office of Revenue Sharing of the available literature on the impacts of the current formula and known alternatives, and an additional year of research and development conducted by Treasury's Office of State and Local Finance.

<u>The Proposed Allocation of Local Revenue Sharing Funds Under the New Program</u>

Let me now describe specifically the basic elements of our recommendations for a new, five-year Revenue Sharing Program involving $4.6 billion in annual payments to local governments.

<u>Interstate Distribution</u>

The allocation of funds under the current Program begins with an interstate allocation. Each State (not the State government) receives the higher amount of what it would receive under the three-factor Senate formula (population, relative income, and tax effort) or the five-factor House formula (population, tax effort, relative income, income tax receipts, and urbanized population). This approach reflects a compromise between regions and areas effected when the Program was first approved by Congress. It is particularly important to continue these interstate allocation procedures because the sectional and regional conflicts they resolve may be even more intense today than they were in 1972.

It should be pointed out that these procedures have more to recommend them than the fact that they effectively resolve significant conflicts in our national politics. For example, the Advisory Commission on Intergovernmental Relations reports that the interstate distribution of Revenue Sharing funds is generally consistent with its index of fiscal stress.

Intrastate Allocation of Funds

Once the Revenue Sharing funds are allocated among the States, the intrastate allocation procedure begins. The fundamental strength of the allocation of Revenue Sharing funds rests with this intrastate formula. The key variables of the formula--population, relative income, and tax effort--direct funds among county areas within a State and within each area in a manner that tends to reduce disparities in the fiscal capacities of local governments. In its current form, however, the capacity of the intrastate formula to contribute to fiscal equity is unduly limited in several important respects. Thus, we are proposing the following changes.

1. De-Tiering

The current formula first allocates funds to county areas within a State and then to individual jurisdictions within each county. This "tiering" procedure causes some significant inequities in the allocation of funds. For example, low- and moderate-income jurisdictions in relatively wealthy counties receive substantially less funding than they would receive if they were located in a county with the same income as their own. Conversely, wealthy jurisdictions located in relatively low-income counties receive disproportionately high payments.

To eliminate these inequities, the Administration proposes that the initial allocation to county areas be eliminated and that all local governments within a State compete for funds on a common basis. The result of this will be to provide all jurisdictions with the same income levels and tax efforts in a given State the same level of funding on a per capita basis.

2. Maximum and Minimum Grant

The formula now ensures each locality a per capita Revenue Sharing payment equal to 20 percent of the average per capita Revenue Sharing payment to all local governments in the same State. The formula also limits per capita grants to 145 percent of the State average. The minimum guarantees a substantial level of funding for all jurisdictions, regardless of their wealth or the scope of their responsibilities. The maximum

limits the funding available to severely stressed jurisdictions; that is, those with relatively low per capita incomes and very high tax efforts.

In order to reduce the seriousness of the inequities introduced by these constraints, the Administration is recommending that the minimum be lowered from 20 to 10 percent and that the maximum be raised from 145 to 175 percent. The maximum of 175 percent is appropriate because an appreciably higher limit would direct a disproportionate share of Revenue Sharing funds to a single large city in several States. The lower limit is appropriate because no single formula change should result in more than a 50 percent reduction in funding.

3. Budget Constraint

Some limited-purpose jurisdictions collect very small amounts of taxes and receive little intergovernmental revenue. For such governments, the minimum-payment provision results in a Revenue Sharing grant that is sufficient to finance a very large proportion of their budgets. To limit these governments' dependency on Revenue Sharing, the current formula restricts the amount of the grant to 50 percent of a jurisdiction's total adjusted (non-education) tax collections and intergovernmental revenues (not including Revenue Sharing). This provision is commonly referred to as the budget constraint. As this constraint is currently defined, Revenue Sharing is financing one-third of the budgets of more than 500 jurisdictions. (In contrast, Revenue Sharing finances less than 6 percent of the budgets of all local governments.)

As presently constituted, this provision has provided a strong incentive for the preservation of limited-purpose jurisdictions. Every increase of a dollar in local tax revenue or intergovernmental transfers received by such a locality, if the minimum payment were not limited by the budget constraint, qualifies it for an additional 50 cents in Revenue Sharing funds.

Reduction of the minimum per capita payment from 20 percent to 10 percent will reduce the significance of this inequity, but no government receiving the minimum should be able to finance more than a fifth of its budget from Revenue Sharing. Thus, we are recommending that the budget constraint be reduced from 50 to 25 percent. This recommendation is in keeping with the principle that no single formula change should result in more than a 50 percent reduction in any locality's funding.

The reduction of the budget constraint necessitates a complementary formula change. Under the current formula, funds not allocable to a city or town because of the budget constraint are assigned to the county government that overlies

the jurisdiction. If the county government is also constrained, the funds are allocated to the State government. Since State governments will no longer be eligible to receive Revenue Sharing, the Administration is proposing that these funds be reallocated to unconstrained local governments throughout the State.

4. Scale-Down for High-Income Jurisdictions

From the beginning of the Revenue Sharing Program, concern has been expressed that wealthy jurisdictions receive excessively large payments. Many very high-income communities now receive Revenue Sharing payments that cannot be justified by any reasonable concept of need. This is thoroughly inconsistent with the Administration's view of the fundamental objectives of the Program. Thus we are proposing that the Revenue Sharing entitlements of very high-income jurisdictions be scaled-down, at a moderately more rapid rate than the current formula provides, by an amount that increases with the income level of the jurisdiction.

This can best be accomplished by the following formula modification: for each jurisdiction with a per capita income higher than 115 percent of its State's average, the jurisdiction's tax-effort factor in the formula will be reduced by somewhat more than the percentage that its per capita income exceeds 115 percent of the State average. The rationale for initiating the scale-down at 115 percent is to limit the effect of the provision to the wealthiest 10 percent of all local governments in the nation.

5. Normalization of Adjusted Taxes

The current Revenue Sharing formula credits several hundred relatively small jurisdictions with very high tax effort, but in actual fact their citizens are not subject to onerous tax burdens. These jurisdictions are "tax enclaves" that export very large proportions of their taxes. In order to normalize the tax efforts of such jurisdictions, the following formula modification is proposed: the adjusted taxes included in the calculation of tax effort for a jurisdiction will be reduced by one dollar per capita below 250 percent of the per capita adjusted taxes of similar jurisdictions in the State (counties, cities, or towns) for each dollar that its per capita adjusted taxes exceed 250 percent of that statewide average.

This provision would not apply to a jurisdiction with per capita adjusted taxes under $250, or to a jurisdiction that is the sole local government for its geographic area (for example, a city-county government). The $250 limitation is designed to protect counties and townships that provide fairly high levels of services in States where the overwhelming majority of similar

limitation protects jurisdictions whose taxes are high simply because they are responsible for services that are provided by two or more overlying jurisdictions elsewhere in the State.

Overview of the Impacts of the Formula Modifications

In the aggregate, the proposed formula changes will shift approximately $200 million among local governments (less than 5 percent of total payments to localities). In terms of net impacts: cities, Indian tribes, and rural counties realize the largest gains; urban counties experience modest losses, and townships fairly significant losses. Computer printouts detailing the consequences of the Administration's proposals for every local government in the nation have been made available to this Subcommittee. The printouts include the $500 million of transitional assistance. Allocations showing the distribution of funds in fiscal years 1983 through 1985 will be provided in the next few days.

In general, the formula changes will increase funding for large cities, and will improve the responsiveness of the allocation to variations in tax effort and per capita income. Wealthy jurisdictions will experience substantial reductions in funding. Payments to a majority of the nation's 105 largest county governments, typically suburban jurisdictions, will be reduced moderately; a few very high-income counties will experience large reductions. Lower-income counties will experience moderate gains. Small towns and poor rural jurisdictions that offer a full range of local services will be provided additional funds.

The consequences of the formula changes vary from State to State depending on interactions between local government organization and geographical patterns or demographic structure. For example, the impacts on major cities tend to be different in the Northeast and Midwest from those in the South and Southwest. In the Northeast and Midwest, most very large cities have relatively low per capita incomes and much higher tax efforts compared with the rest of their States, and especially compared with their surrounding suburbs. As a consequence, they will experience increases in Revenue Sharing funding under the revised formula, often at the expense of their suburbs. In the South and Southwest, many cities have per capita incomes significantly higher than the rest of their States. Consequently, the new formula shifts Revenue Sharing funds from these jurisdictions to relatively poor, high-tax-effort jurisdictions, often in the rural areas of those States.

Compliance Requirements

Under the present Program, no recipient may discriminate on the basis of race, color, national origin, sex, age, handicap, or religion in activities funded by Revenue Sharing. In addition, recipients must hold public hearings on their budgets to provide their residents an opportunity to comment on proposed appropriations of the Revenue Sharing grants. The Administration recommends continuation of these compliance requirements.

Jurisdictions receiving annual payments totaling $25,000 or more must have an audit in accordance with generally accepted auditing standards at least once every three years under the present Program. The Administration proposes to require an audit of every year's books conducted at least once every other year during the new Program.

Transitional Assistance

The termination of Revenue Sharing payments to State governments, beginning in January 1981, will reduce State revenues by $2.3 billion per year. Revenue Sharing is a relatively minor component of State budgets--averaging 2 percent of their total tax receipts. Nevertheless, the loss of Revenue Sharing payments to State governments is likely to result in substantial reductions in the aid that the States provide to their localities.

Reliable estimates of the likely losses in State aid are not available for most individual local governments because the fiscal impact analysis necessary to identify the magnitudes of such losses has been done in only a few cases. For the same reason, estimates of the aggregate losses to all localities in each State are also unavailable. However, a recent study commissioned by the Treasury Department of the fiscal impacts of terminating Revenue Sharing payments to the States concludes that the total loss to local governments nationwide may be as large as $1.4 billion.

In light of the magnitude of these potential reductions in State aid, the Administration is recommending that an additional $500 million be distributed to all local governments along with their regular Revenue Sharing payments in fiscal years 1981 and 1982. The objective will be to give local governments time to adjust their financial plans to the loss of State aid.

Even though estimates of direct local losses of State aid are unavailable, we expect that the losses will be most severe in States where aid to local governments is a large proportion of State government budgets. On the other hand, in States where

such aid is a less important factor in State budgets, the local losses are likely to be relatively minor. Accordingly, the Administration is proposing that the $500 million in transitional assistance be allocated among the States in proportion to the amount of aid that each State government pays to its general-purpose local governments for purposes other than education. For example, if a particular State accounts for 5 percent of all State aid to general-purpose local governments in the country, that State will receive 5 percent of the $500 million, or an additional $25 million in 1981 and 1982.

The transitional assistance will be added to each State's share of the $4.6 billion in regular Revenue Sharing payments. The total amount allocated to a State will then be distributed among all general-purpose local governments in the State by the revised Revenue Sharing formula, which is discussed earlier in my testimony.

We believe that this procedure for allocating the transitional assistance will ensure (1) that the funds will be distributed to local governments in States where the loss of Revenue Sharing is most likely to reduce State aid to local governments, and (2) that the distribution of the payments within each State will favor the fiscally stressed local governments that are most likely to need help in adjusting to the loss of State aid.

Conclusion

The President believes, and I believe, that through Revenue Sharing we can address the fiscal problems of local governments in the 1980's, and build a firm financial foundation for the future of government in America. A vital and responsive federal system should be a national priority. But setting priorities, and finding ways to meet them, always require debate. Let us begin today a national debate on the future of American federalism.

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STATEMENT BY THE HONORABLE G. WILLIAM MILLER
SECRETARY OF THE TREASURY
FOR THE HOUSE SUBCOMMITTEE ON APPROPRIATIONS
APRIL 17, 1980, 2:00 P.M.

Mr. Chairman, Members of the Committee:

I am pleased to be here with you to discuss the Department of the Treasury operating budget request for fiscal year 1981.

Mr. Chairman, I understand that this will be your final hearing on the Treasury Department before your retirement. I would like to express my appreciation to you, Mr. Chariman, for your many years of understanding and encouragement for Treasury programs. I know that your appropriation hearings have always been conducted on an open and fair minded basis. Your knowledge and support of key Treasury activities have been instrumental in many areas in insuring that these activities can be funded and carried out in a manner that serves the public effectively and efficiently. I know I speak for the many Treasury officials who appeared before you over the years in thanking you and wishing you all of the best in your retirement.

The Treasury bureau heads have already appeared before you to justify their individual requests. With your permission, Mr. Chairman, I would like to insert in the record a summary of the highlights of our budget justifications before your Committee.

We are requesting $3.6 billion and 118,377 average positions for our regular operating appropriations for fiscal year 1981. This represents an increase of $35 million and 568 positions over fiscal year 1980, primarily in the Internal Revenue Service. These amounts reflect the President's budget revisions.

Before discussing the Treasury Department's budget requests, I would like to comment briefly on our overall economic policy. As you know, on March 14, President Carter announced strong new measures to arrest inflation. The steps he proposed are bound to be very painful and difficult. But I believe the American people, the Congress and the Administration are now united in their determination to bring inflation under control and to regain control over our economic destiny. This new consensus is the strongest tool of all in the fight against inflation.

The new measures we must take against inflation were developed through one of the most extensive consultations with Congressional leaders in our history. We are greatly heartened by the spirit of cooperation and determination reflected in these discussions.

The new measures mark a substantial intensification of our on-going anti-inflation efforts on every front: restraint in Federal spending to close the budget deficit, restraint on credit expansion, efforts to reduce oil imports, and structural reforms to enhance economic efficiency. The fight against inflation is a dynamic process. It cannot be won by a single "package" of measures. What is required is consistency and persistence, coupled with a willingness to adapt particular policies to changing economic circumstances.

Economic circumstances have changed significantly since the time the FY 1981 budget was put together last fall. Through the end of last year, virtually all of the acceleration in inflation was accounted for by energy, and by the higher home financing costs associated with more stringent monetary policy. But in January and February, this inflationary acceleration began to spread into a broad range of goods and services, indicating a worsening of long-term inflationary expectations.

At the same time, increased international tensions gave rise to concerns that expanded defense spending would increase the budget. Fears developed that the 1981 deficit would expand beyond the $16 billion represented by the President's proposals.

These forces also combined to generate serious disturbances in financial markets. Interest rates rose very rapidly on virtually all financial instruments and some financial markets virtually ceased to operate.

It was to respond forcefully to these changes in economic circumstances that the President announced new actions for combatting inflation, coupled with efforts to augment the programs already in place.

First: The balanced budget for FY 1981 that the Administration is submitting to the Congress will be the first balanced budget since 1969. We must recognize that prudent fiscal policy demands that the budget oscillate around a true balance over the business cycle. During the 1970's, we have had continuous deficits, in both good times and bad.

The new budget represents a powerful economic force. The swing toward fiscal restraint between FY 1980 and FY 1981 will be approximately $50 billion, the largest ever in nominal terms and one of the largest ever as a percentage of GNP. And this increased fiscal stringency begins immediately: many of the budget cuts will affect FY 80 as well as 1981, and the gasoline conservation fee already [illegible] President will begin generating revenues this

Because of this shift in fiscal policy, Treasury demands on private capital markets will be reduced substantially. Federal Borrowing from the public will be reduced by approximately $5 billion in Fiscal year 1980 and by over $30 billion in Fiscal 1981.

Balancing the Federal budget is the single most important step we can take to reduce inflationary expectations and return order to capital markets.

<u>Second</u>: By invoking the Credit Control Act of 1969, the President has given the Federal Reserve new tools to slow the growth of consumer and business borrowing.

Much of the strong growth in consumer spending over the last year was fueled by increased consumer debt, and an accompanying decline in the personal savings rate to the lowest level in 30 years. From January 1979 to January 1980, balances due by consumers on bankcards and other revolving credit increased by 17 percent, and consumer loans at finance companies increased by 25 percent. It is essential that consumer borrowing not add further to inflationary pressures, either by stimulating consumption at the expense of savings, or by encouraging consumers to buy now in anticipation of higher prices later.

We have also seen very strong growth in business credit over the last few months. From late December through mid-March, business borrowing from all short-term sources grew at one of the fastest rates ever recorded for a similar period, a development clearly inconsistent with reducing inflation.

Relying solely on the traditional tools of monetary policy to diminish credit growth would have placed unnecessary strains on the financial system. The new tools under the Credit Control Act will mitigate that stress. However, there actions imply no diminution in the Fed's commitment to deploy the conventional tools of monetary policy as an anti-inflationary weapon. The President invoked the Act in ways carefully designed to complement and make more effective the traditional methods of monetary control.

<u>Third</u>: The 10 cent per gallon gasoline conservation fee provides further impetus toward the vital objective of reducing our use of imported oil. Twice in the last 10 years, in 1974 and 1979, we experienced dramatic increases in the price of imported oil; both times inflation worsened seriously worldwide. In 1979 alone, the price of imported petroleum increased by about 100%. To regain control of our own economic destiny, we must reduce our dependence on imported oil.

We estimate the gasoline conservation fee will reduce oil imports by about 100,000 b/d in the short-run, and as much as 250,000 b/d over the longer-run. The fee is a transitional measure; the Administration will submit to the Congress a tax equivalent to an <u>ad valorem</u> tax on motor fuels. Once it becomes effective, the new equivalent <u>ad valorem</u> tax will replace both the present 4 cents a gallon tax and the conservation fee.

The steps the President took on March 14, in concert with the programs already in place, comprise a comprehensive attack on the major factors contributing to inflation. The program addresses the root causes of inflation, not merely the symptoms. We have endured a decade of persistent budget deficits, very high inflation, and soaring oil import bills. Reversing these trends will take firm and patient leadership. I believe, however, that we will succeed. What we are witnessing in Washington and throughout the nation is, in my judgment, the formation of a new and deep commitment to a process of economic renewal.

Let me return now to the Treasury Department's fiscal year 1981 budget.

Fiscal Year 1981 Treasury Overview

As I mentioned before, the estimates contained in the President's budget for fiscal year 1981 indicate that the Treasury will require a total of $3.6 billion for operating accounts.

I would like to bring to the Committee's attention some of the highlights of the type and level of workload facing the Department in fiscal year 1981. For example:

-- The Department will process over 139 million tax returns in fiscal year 1981, an increase of over 2 million from the previous year.

-- We expect an increase of over 9 percent in delinquent tax accounts processed and secured.

-- We estimate that 40.3 million taxpayers will come to us for assistance.

-- We anticipate that 284 million persons will be arriving at U.S. borders -- 3 percent more than in 1980 -- and that we will be processing almost 5 million formal entries -- almost 7 percent more than 1980.

-- We expect to manufacture approximately 15 billion coins in 1981.

-- Over 153 million savings-type securities will be issued and almost 163 million retired.

-- The Department will also issue 729 million checks, an increase of over 2 percent.

The $3.6 billion request for 1981 represents a net increase of $35 million and 568 average positions over 1980 levels. Of the total, $34 million and 409 average positions are needed to handle additional workload generated outside the Department and is totally uncontrollable by us. The need $22 million of this

amount for processing and examining additional tax returns, collecting delinquent taxes and for legal services. $10 million will be needed by the Bureau of the Public Debt for issuing and redeeming securities, while the remaining $2 million is for other miscellaneous increases.

The major program expansion -- that is, an increase in the quality of our programs -- contained in our estimates involves $36 million and 1,166 average positions. This program increase is made up of several major items and many small but necessary items scattered throughout the Department. The increases are shown below:

-- $20.9 million and 989 average positions to provide resources in the Internal Revenue Service for matching of information returns and follow-up collections -- with an estimated revenue return of $375 million.

-- $5.1 million to provide for site preparation at several IRS Service Centers in support of the ADP Equipment Replacement Program.

-- $3.0 million and 135 average positions to provide additional resources in the IRS to collect unpaid accounts -- producing a revenue return of approximately $55 million.

-- $6.9 million and 42 average position for other program increases spread across the other Treasury Bureaus.

These increases are offset by a net reduction of $34.5 million and 1,007 average positions. This represents the cost of maintaining current operating levels on Treasury programs offset by one-time costs savings, management improvements, and productivity savings.

The operating accounts in the budget estimate reflect our continuing effort to strike a reasonable balance between the Department's program needs and the desire to stabilize the growth in Government spending. The increases in this budget do help offset the impact of inflation on the Department. It is my view that the budget estimate before you will assure that the revenue is protected, that income tax returns are processed, that customs declarations and duties are effeciently collected and deposited, and that alcohol and tobacco excise taxes are promptly collected. It provides adequate funding to secure necessary financing to pay the Government's bills and maintain the Government books in a businesslike manner.

In addition, the budget estimate provides for an even-handed law enforcement effort. While the significant responsibilities for law enforcement rest with the Department of Justice, the Treasury Department is responsible for that segment of law enforcement related to the protection of currency, the tax system, and the customs and excise taxes, as well as regulation and control of firearms, explosives, and smuggling.

I would like to insert Table 2 into the record to show the relationship between our average position and dollar requirements, as well as Table 3, which illustrates the detailed derivation of Treasury's "proposed authorized level for 1980."

Mr. Chairman, this concludes my prepared statement. I shall, of course, welcome the opportunity to answer any questions you may have. Thank you.

Table 1

THE DEPARTMENT OF THE TREASURY

Annual Approporiations for the FY 1980 and
Estimates Requirements for FY 1981

(In Millions of Dollars)

Regular Operating Appropriations:	1980 Proposed Authorized Level	Revised 1981 Budget Estimates	Increase (+) Decrease (-) Compared to 1980
Office of the Secretary	$ 31.8	$ 34.0	$ +2.2
International Affairs	22.8	23.7	+.9
Federal Law Enforcement Training Center	13.4	13.4	---
Bureau of Gov't Financial Oper:			
Salaries and Expenses	190.0	188.0	-2.0
Payments to Guam, V.I. and American Somoa	2.0	---	-2.0
Government Losses in Shipment	.2	---	-.2
Bureau of Alcohol, Tobacco and Firearms	143.7	144.8	+1.1
U.S. Customs Service	464.3	465.7	+1.4
Bureau of the Mint:			
Salaries and Expenses	59.4	61.0	+1.6
Bureau of the Public Debt	209.6	196.6	-13.0
Internal Revenue Service:			
Salaries and Expenses	150.0	157.8	+7.8
Taxpayer Ser. & Returns Proc.	802.7	811.7	+9.0
Examinations and Appeals	837.3	852.9	+15.6
Investigations and Collections	501.4	536.7	+35.3
Total, Internal Revenue Ser.	2,291.4	2,359.1	+67.7
Payment Where Energy Credit Exceeds Tax Liability	1.9	---	-1.9
U.S. Secret Service	177.7	157.0	-20.7
TOTAL, Regular Operating Appro.	$3,608.2	$3,643.3	$+35.1

Table 2

THE DEPARTMENT OF THE TREASURY

Comparative Statement of Average Positions
Fiscal Year 1980 and 1981

(Direct Appropriations Only)

	1980 Authorized Level	Revised 1981 Budget Estimate	Increase (+) Decrease (-) Compared to 1980
Regular Operating Appropriations:			
Office of the Secretary	787	798	+11
International Affairs	487	458	-29
Federal Enforcement Training Center	253	256	+3
Bureau of Gov't Financial Oper.	2,750	2,696	-54
Bureau of Alcohol, Tobacco and Firearms	3,778	3,737	-41
U.S. Customs Service	13,643	13,529	-114
Bureau of the Mint	1,722	1,710	-12
Bureau of the Public Debt	2,679	2,640	-39
Internal Revenue Service:			
Salaries and Expenses	4,558	4,666	+108
Taxpayer Ser. & Returns Proc.	34,995	34,141	-854
Examinations and Appeals	30,367	30,292	-75
Investigations and Collections	18,264	19,928	+1,664
TOTAL, IRS	88,184	89,027	+843
U.S. Secret Service	3,526	3,526	---
TOTAL, Regular Operating Appro.	117,809	118,377	+568

Table 3

THE DEPARTMENT OF THE TREASURY
Derivation of "Proposed Authorized Level for 1980"
(In Thousands of Dollars)

1980 Appropriation..$3,435,622

Proposed Supplementals:

1. Pay Increase:

   a. Classified..........................$132,284
   b. Wage Board..........................   229   +132,513

2. Program:

   a. Government Financial Operations (Payments to Virgin Islands) - This proposed supplemental appropriation would provide funds to reimburse the Government of Virgin Islands for losses incurred under the Tax Reduction and Simplication Act of 1977......................$2,000

   b. Internal Revenue Service (Payment Where Energy Credit Exceeds Tax Liability) - Provides for additional payments to businesses when the solar wind credit due them exceeds the amount of tax liability owed........................$1,000

   c. Public Debt - Provides for increase workload occurring in savings bond redemptions, Treasury bill book-entry accounts, and other Bureau operations..........................$23,558

   d. Secret Service - Provides for the increase cost of protective travel, Presidential candidate and nominee protection (10,800) and reimbursements to State and Local governments for protection of foreign diplomatic missions under extraordinary circumstances (2,750)...$13,550   +40,108

Proposed Appropriation Transfer:

1. Office of the Secretary (transfer of Anti-Dumping and Countervailing Duty Program to Commerce)   -329

2. International Affairs (transfer to Special Trade Representative)   -88

3. U.S. Customs Service (transfer of Anti-Dumping and Countervailing Duty Program to Commerce)   -5,271

4. U.S. Secret Service (transfer from Mint construction account to fund pay increase requirements)   +5,730   +42

Proposed Authorized Level for 1980..........................$3,608,285

THE DEPARTMENT OF THE TREASURY

HIGHLIGHTS OF THE PRESIDENT"S FY 1981 BUDGET

The President's Budget for the Department of the Treasury Requests $79,001,042,000 for FY 1981 -- a decrease of $16,333,208,000 compared to 1980. This represents an increase of $6,300,000,000 for interest on the public debt, an increase of $75,118,000 for operating accounts ($35,070,000 under Treasury-Post Office Subcommittee, $40,246,000 under Hud-Independent Agencies Subcommittee and a decrease of $198,000 under the State, Judiciary and Commerce Subcommittee), and a decrease of $22,708,326,000 in all other accounts, such as trust funds and revolving accounts, receipts, energy security corporation, and indefinite accounts. Funds for the Department's operating programs total $3,741,365,000 an increase of $75,118,000 over 1980. These operating programs are the ones that receive the most scrutiny by our Congressional Appropriations Committees.

Relative to the Department's employment, the budget provides for a 1981 level of 118,555 average positions (118,377 under Treasury-Post Office Subcommittee, and 158 under HUD-Independent Agencies Subcommittee and 20 under the State, Judiciary and Commerce Subcommittee) for the operating accounts, an increase of 576 (568 under Treasury-Post Office Subcommittee and 8 under the State, Judiciary and Commerce Subcommittee) compared to 1980.

Budget Authority Increases for Treasury Subcommittee Operating Accounts -- Net $35,070,000

+ 33,799,000 -- to meet workload increases, for the following items: $8.2 million for processing tax returns, $4.1 million for examination of tax returns, $7.0 million for collection of delinquent taxes, $3.0 million for legal services, $1.2 million for check issuance, $9.7 million for issuing and redeeming securities, $0.3 million for Office of the Secretary workload, and $0.3 million for other increases.

+ 20,869,000 -- to provide additional resources in the Internal Revenue Service for matching of information returns and follow-up collections.

+ 5,081,000 -- to provide for site preparation of several IRS Service Centers in support of the ADP equipment replacement program.

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Increases - Operating Accounts (continued)

+ 2,980,000 -- to provide additional resources in the IRS to collect unpaid accounts.

+ 600,000 -- for repairs and improvements to the Treasury Annex elevators.

+ 2,937,000 -- to provide for acquisition of equipment in several Treasury bureaus.

+ 350,000 -- to provide additional resources in the Secret Service for technical security.

+ 700,000 -- for the Salary Equalization Program, Asian Development Bank.

+ 2,292,000 -- for other program increases.

+ 90,179,000 -- to maintain current levels of operation -- within-grade promotions, grade to grade promotion, space rental, FTS costs, printing costs, health benefits, etc.

-124,717,000 -- for non-recurring equipment, one-time costs, and savings and certain program reductions.

Employment - Increase of 568 Average Positions

+ 409 -- average positions of new employees to meet workload increases for the following items: 397 for collection of delinquent taxes, 10 for manufacturing of coins in Mint, 2 for the Office of the Secretary and Government Financial Operations.

+ 989 -- average positions to provide additional resources in IRS for matching of information returns and follow-up collections.

+ 135 -- average positions to provide additional resources in IRS to collect delinquent unpaid accounts.

+ 10 -- average positions for the check payment and reconciliation program in GFO.

+ 32 -- average positions for other program increases.

+ 34 -- average positions to provide full-year cost in 1981 for programs authorized for part of 1980.

- 1,041 -- average positions for non-recurring savings, program reductions, and productivity savings.

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Assumptions

The estimates are based on the assumptions that:

-- All possible efforts will be made to hold Government expenditures to a minimum particularly in this budget year when most workload increases have been offset by productivity savings and program reductions.

-- Pay increases for classified employees under Executive Order 12165 will be provided in 1980 supplemental appropriations.

-- Increased productivity and management savings will be applied to the maximum extent.

-- Demands for Treasury services will continue to increase and must be met:

* Government checks issued and paid.
* Bond and security records maintained.
* Coins, currency and stamps produced for nation's commerce.
* Internal Revenue master file maintained in a current manner and tax returns processed.
* Check claims cases settled promptly.
* Cargo and persons entering our borders should be processed equitably and efficiently.
* Smuggling of all contraband should be identified and halted where possible.

Summary Analysis of FY 1981 Estimates for Operating Bureaus and Offices

Office of the Secretary - $33,995,000

-- Net increase is $2,241,000 and 11 average positions of employment.

-- $344,000 and 8 average positions are needed for increased workload.

-- $600,000 is requested for repairs and improvements to the Treasury Annex elevators.

-- $325,000 and 10 average positions are included for the new insurance office.

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Office of the Secretary (continued)

-- $1,477,000 and 2 average position are needed to maintain current levels of operations - within-grade promotions, annualization of pay increases, space rental costs, etc.

-- A reduction of $505,000 and 9 average positions are principally for non-recurring and one-time costs and productivity savings.

International Affairs - $23,671,000

-- Net increase is $834,000 and a decrease of 29 average positions of employment.

-- $700,000 is required for the Salary Equalization Program, Asian Development Bank.

-- $1,558,000 is provided to maintain current levels of operation -- within-grade promotions, price increases, annualization of pay increases, etc.

-- A reduction of $1,424,000 and 29 average positions is for productivity savings and non-recurring-one-time costs.

Federal Law Enforcement Training Center - $13,400,000 for Salaries and Expenses

-- Net decrease for Salaries and Expenses of $2,000 and an increase of 3 average positions of employment.

-- An increase of $753,000 and 3 average positions are for the costs related to maintaining current levels of operations -- within-grade promotions, annualization of pay increases, price increases, etc.

-- A reduction of $755,000 is for productivity savings, program reductions, and non-recurring one-time costs.

Bureau of Government Financial Operations

Salaries and Expenses - $188,012,000

-- Net decreases are $2,027,000 and 54 average positions of employment.

-- $1,193,000 and a decrease of 6 average positions are for workload in the check issuance area.

-- $490,000 is to provide for ADP and capital equipment acquisitions.

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GFO, Salaries and Expenses (continued)

-- $486,000 and 10 average positions are for the check payment and reconciliation program.

-- $229,000 and 5 average positions are for other program increases.

-- $1,539,000 is required to maintain current staff levels -- within-grades, space rental, annualization of postage increases and full-year costs of programs authorized for part of 1980.

-- Reductions of $5,964,000 and 63 average positions for management savings, non-recurring one-time costs and program reductions.

Payments to Guam, Virgin Islands and American Samoa - $-2,000,000

-- A net reduction of $2,000,000 for one-time payments occuring in 1980.

Government Losses in Shipment - $-200,000.

-- A net reduction of $200,000 for one-time payment occuring in 1980.

Bureau of Alcohol, Tobacco and Firearms - $144,844,000

-- A net increase of $1,142,000 and a reduction of 41 average positions of employment.

-- $997,000 is required for additional equipment.

-- $3,666,000 is for costs to maintain current levels of operations which include such items as within-grade promotions, grade to grade promotions, and increased printing, postage, and space costs.

-- A reduction of $3,521,000 and 41 average positions for program reductions and non-recurring costs and savings.

U.S. Customs Service - $465,700,000

-- Net increase of $1,361,000 and a reduction of 114 average positions of employment.

-- $1,450,000 is for additional vehicles and enforcement equipment.

-- $386,000 and 8 average positions are for the regulatory audit program.

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U.S. Customs Service (continued)

-- $525,000 and 9 average positions are for safety and health programs.

-- An increase of $11,467,000 and 29 average positions are to maintain current levels of operation -- within-grade promotions, grade to grade promotions, price increases, annualization of pay increases, space increases, etc.

-- A reduction of $12,467,000 and 160 average positions are for non-recurring costs and savings, productivity savings, and program reductions.

Bureau of the Mint

Salaries and Expenses - $60,956,000

-- Net increase for Salaries and Expenses, $1,599,000 and a decrease of 12 average positions.

-- $205,000 and 10 average positions are for increased workload.

-- $4,323,000 is required to maintain current levels of operation -- within-grade promotions, annualization of pay increases, FTS costs, etc.

-- A reduction of $2,929,000 and 22 average positions is for non-recurring costs and savings and program reductions.

Bureau of the Public Debt - $196,625,000

-- A reduction of $13,015,000 and a reduction of 39 average positions of employment.

-- $9,671,000 is for compensation of issuing and paying agents for redemption and sale of savings bonds and reimbursement to Federal Reserve Banks for services.

-- $341,000 is for other program increases.

-- $2,418,000 to maintain current levels of operations, including such major items as within-grade promotions, annualization of pay increases, space rental costs, annualization of postage, etc.

-- A reduction of $25,445,000 and 39 average positions for non-recurring costs, and management savings.

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Internal Revenue Service - $2,359,111,000

Salaries and Expenses - $157,762,000

-- A net increase of $7,782,000 and 108 average positions of employment.

-- $3,152,000 and 63 average positions are for increased workload.

-- $6,678,000 and 60 average positions are to maintain current levels of operations -- within-grade promotions, annualization of pay increases, space rental costs, etc.

-- A reduction of $2,048,000 and 15 average positions covering non-recurring costs and savings and program reductions.

Taxpayer Service and Returns Processing - $811,744,000

-- Net increase of $8,996,000 and a decrease of 854 average positions of employment.

-- $8,202,000 and 4 average positions for processing additional tax returns.

-- $5,750,000 and 302 average positions are for matching additional information returns and related follow-up collections.

-- $5,081,000 is for site preparation at several service centers in support of the ADP Equipment Replacement Program.

-- An increase of $13,856,000 and a reduction of 812 average positions is to maintain current levels of operations including such items as within-grade promotions, grade-to-grade promotions, annualization of pay raises, etc.

-- A reduction of $23,893,000 and 348 average positions is for non-recurring costs and savings and program reductions.

Examinations and Appeals - $852,925,000

-- A net increase of $15,609,000 and a decrease of 75 average positions of employment.

-- An increase of $4,069,000 for examination of additional tax returns.

-- An increae of $4,527,000 and 233 average positions for examinations of tax returns derived from the information returns program.

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IRS, Examinations and Appeals (continued)

-- An increase of $19,103,000 and a reduction of 63 average positions are to maintain current levels of operations including such items as within-grade promotions, grade-to-grade promotions, annualization of pay increases, etc.

-- A reduction of $12,090,000 and 245 average positions is for non-recurring costs and savings and productivity savings.

Investigations and Collections - $536,680,000

-- A net increase of $35,259,000 and 1,664 average positions of employment.

-- $6,963,000 and 330 average positions are for collection of delinquent taxes related to additional workload.

-- $10,592,000 and 454 average positions are for follow-up investigations derived from the information returns program.

-- $2,980,000 and 135 average positions are for an increased effort to collect unpaid accounts.

-- $21,002,000 and 815 average positions to maintain current levels of operation -- within-grade promotions, grade-to-grade promotions, space rental costs, annualization of pay increases and programs authorized for part of FY 1980 etc.

-- A reduction of $6,278,000 and 70 average positions covering non-recurring costs and savings and program reductions.

Payment where Energy Credit Exceeds Tax Liability - $-1,900,000

-- Net decrease of $1,900,000 for one-time non-recurring costs in 1980 (this account is proposed as an indefinite in 1981).

U.S. Secret Service - $157,041,000

-- Net decrease is $20,609,000 with no change proposed in average positions.

-- $350,000 is for technical security equipment.

-- $2,339,000 is for those costs required to maintain current levels of operation -- within-grade promotions, grade-to-grade promotions, annualization of pay, space rental, etc.

-- A reduction of $23,298,000 is for non-recurring equipment costs and program reductions primarily related to the candidate and nominee protection program in the 1980 budget.

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FOR RELEASE AT 4:00 P.M. April 16, 1980

TREASURY TO AUCTION $4,000 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $4,000 million of 2-year notes to refund $2,721 million of notes maturing April 30, 1980, and to raise $1,279 million new cash. The $2,721 million of maturing notes are those held by the public, including $704 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $459 million of the maturing securities that may be refunded by issuing additional amounts of the new notes at the average price of accepted competitive tenders. Additional amounts of the new security may also be issued at the average price to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing securities held by them.

Details about the new security are given in the attached highlights of the offering and in the official offering circular.

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Attachment

M-437 (Over)

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED APRIL 30, 1980

April 16, 1980

Amount Offered:	
To the public	$4,000 million
Description of Security:	
Term and type of security	2-year notes
Series and CUSIP designation	Series R-1982 (CUSIP No. 912827 KQ 4)
Maturity date	April 30, 1982
Call date	No provision
Interest coupon rate	To be determined based on the average of accepted bids
Investment yield	To be determined at auction
Premium or discount	To be determined after auction
Interest payment dates	October 31 and April 30
Minimum denomination available	$5,000
Terms of Sale:	
Method of sale	Yield auction
Accrued interest payable by investor	None
Preferred allotment	Noncompetitive bid for $1,000,000 or less
Payment by non-institutional investors	Full payment to be submitted with tender
Deposit guarantee by designated institutions	Acceptable
Key Dates:	
Deadline for receipt of tenders	Tuesday, April 22, 1980, by 1:30 p.m., EST
Settlement date (final payment due from institutions)	
a) cash or Federal funds	Wednesday, April 30, 1980
b) readily collectible check ...	Friday, April 25, 1980
Delivery date for coupon securities.	Wednesday, May 7, 1980

ıartment of the TREASURY
INGTON, D.C. 20220 TELEPHONE 566-2041

NEWS

For Release Upon Delivery
Expected at 9:30 a.m. E.S.T.

STATEMENT OF HARRY L. GUTMAN
DEPUTY TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
SUBCOMMITTEE ON SELECT REVENUE MEASURES
April 17, 1980

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to appear today to present the views of the Treasury Department on H.R. 6883, the Installment Sales Revision Act of 1980.

INTRODUCTION

The Installment Sales Revision Act of 1980 is the first major substantive tax simplification effort of this Congress. At hearings on this bill's predecessor, H.R. 3899, Treasury reaffirmed the high priority it places upon simplification as

a tax policy goal. Moreover, we also agreed that the installment sale area was an excellent choice for beginning what we hope will become an ongoing simplification process.

The history of the installment sale bill to date indicates that the tax simplification process is off to a promising start. At the hearings on H.R. 3899, Treasury urged this Subcommittee to go beyond the specific provisions of that bill and address the area of sales for deferred payment more generally. We submitted a number of specific proposals for simplification. Representatives of the Section of Taxation of the American Bar Association, the Tax Committee of the American Institute of Certified Public Accountants and the Tax Committees of the New York State and City Bar Associations testified in support of both the concept and the general framework of the Treasury proposals.

At the completion of the July hearings, Mr. Chairman, you directed the Staff of the Joint Committee on Taxation to meet with Treasury and the various groups who had indicated an interest in this area. The objective was to produce a revised bill incorporating the proposals made and resolving adequately the issues raised in the testimony and comments received by the Subcommittee. Treasury, along with those groups whose representatives were willing to donate the requisite time and effort to engage in constructive dialogue were, thereafter, intimately involved with the staff in the development of the revised installment sale bill.

This consensual process of attacking a discrete area of the tax law has been both instructive and rewarding. The prevailing attitude of those who chose to participate in this process was one of concern for the dual goals of simplification and maintenance of the integrity of a tax based on income. These participants shed parochial interests in order to attain these objectives. The result is H.R. 6883, a bill which Treasury endorses.

H.R. 6883

I do not intend to examine all the technical aspects of H.R. 6883. However, because H.R. 6883 is a more ambitious bill than its predecessor, I should like to mention the major areas in which it differs from H.R. 3899 and also, where appropriate, to highlight the resolution of problems identified in prior testimony.

GENERAL RULE

H.R. 6883 creates a general rule for the reporting of income from deferred payment sales. Under the bill, unless the seller otherwise elects, income generally is recognized as deferred payments are received. Thus, the bill reflects the decision that, in general, deferred reporting of gain is appropriate when payment is deferred. The bill does not, however, alter existing law as to what constitutes payment in any particular year (except as specifically provided in connection with like-kind exchanges described in 1031(b)).

The general rule accomplishes a number of significant and welcome results. First, it eliminates the election requirement of present law and thereby removes a "trap" for taxpayers who, for the most part, desire the deferred reporting privilege. Second, it greatly expands the availability of the deferred reporting privilege to include, in particular, sales in which the seller receives more than thirty percent of the selling price in the year of sale and sales in which the total price is uncertain or subject to a contingency. Third, uncertainty surrounding the calculation of the present law thirty percent threshhold limitation, which has proved a fertile ground for error and litigation, is eliminated. Fourth, the inducement to structure normal business transactions in a byzantine manner in order to achieve deferred reporting of gain is removed.

The key to allowing deferred payment reporting where the gross profit or total contract price (or both) is uncertain or subject to contingencies lies in the development of rules requiring basis to be allocated ratably to the deferred payments. This is recognized in the bill. However, rather than attempting to provide basis allocation rules for every conceivable transaction, the bill provides that specific rules will be prescribed by regulation. Thus, unusual cases can be resolved as they arise.

In general, the regulations to be promulgated pursuant to this authority will provide that, for sales under which there is a stated maximum selling price, basis will be recovered in accordance with a gross profit ratio determined by reference to the stated maximum selling price. In general, where the sales price is indefinite but payable over a fixed period of time, the basis of the property sold would be recovered ratably over that fixed period. In cases where

the selling price and payment period are both indefinite, the regulations will permit ratable basis recovery over some reasonable period of time, such as 20 years. Also, in appropriate cases, basis recovery will be permitted under an income forecast type method.

ELECTION TO ACCELERATE RECOGNITION

Mandatory deferred gain recognition could work hardships where taxpayers desire to accelerate recognition, for example, to use otherwise expiring carryovers. Some witnesses also expressed concern that in the rare case where it was not possible to calculate the value of the consideration to be received by the seller, it would likewise be impossible to provide an adequate ratable basis recovery rule.

These concerns are addressed by permitting taxpayers to elect not to report gain on the installment method. To avoid taxpayer attempts to whipsaw the Internal Revenue Service, an election out of the installment method must generally be made on or before the due date (including extensions) of the taxpayer's return for the year of the sale. An election may be revoked with the consent of the Secretary. That consent will be granted where a tax avoidance purpose is not present.

Where a taxpayer elects out of the installment method, the gain in the year of sale will be equal to the difference between the value of the deferred payment obligation and the seller's basis. This rule is different from that recommended by Treasury in previous testimony. Earlier we had suggested that ratable basis recovery apply also to transactions which were not reported on the installment method. The amount realized in the year of sale would be reduced by an allocable portion of basis and the balance of the basis would be recovered against future payments. Treasury's purpose in suggesting this rule was to provide consistent ratable basis recovery rules and to eliminate the incentive to engage in tax "planning", such as that described at page 203 of the April, 1980 issue of the Journal of Taxation, to achieve basis recovery prior to gain recognition. For purposes of this bill, however, we have accepted the representations of the professional groups that the proposal we previously made would cause difficulty in those rare cases involving unascertainable sales prices and that allowing a cost recovery approach to apply would not invite aggressive structuring of transactions to achieve full basis recovery prior to gain recognition.

The existence of the election out mechanism will enable Treasury and the Internal Revenue Service to monitor the circumstances under which taxpayers choose to accelerate gain recognition or attempt to use this option artificially to structure transactions to obtain basis recovery prior to recognition of gain. If this scrutiny reveals any significant efforts by taxpayer to recreate the morass of options available under present law with regard to basis recovery, we shall ask the Congress to reconsider the tax consequences of an election out.

SALES TO RELATED PARTIES

The installment method is currently abused by taxpayers who sell appreciated property to related persons (for example, a trust set up for the benefit of the seller's children), who immediately resell the property to a third party as a part of a prearranged transaction. The original seller defers recognition of gain. The related person receives the full sale proceeds tax free because the tax basis of the property in the hands of the related person is its purchase price. Thus, the economic unit comprised of the two related persons has cash equal to the value of the property while deferring taxation of the gain which would have been immediately recognized had the initial sale been for cash.

Every responsible witness appearing before the Subcommittee at its hearings on H.R. 3899 recognized that this technique (known as the Rushing rule, after the case which upheld the tax treatment described above) constituted an abuse which should be eliminated. However, all also agreed that the H.R. 3899 flat prohibition of installment reporting for sales between certain related parties was too broad in its impact, particularly where the subject of the installment sale was a farm or closely held business interest.

Testimony in July suggested that a related party sale rule should focus on the source of the abuse -- the disposition of the property by the related party buyer and this is the approach taken by H.R. 6883. Due to the attention this provision has attracted, and in anticipation of further comment by those who appear to believe that tax simplification cannot, by definition, address acknowledged abuses, it is appropriate to describe the related party rule of H.R. 6883 in some detail.

Under the bill, sales to family members, controlled corporations and partnerships, or to trusts and estates in which any related person has a specified interest will be subject to a special disposition rule. For purposes of this rule, persons will be treated as related if stock ownership in any amount would be attributed from one to the other under section 318(a). A subsequent disposition by the related purchaser will result in the acceleration of gain recognition on the installment obligations held by the seller equal in amount to the consideration received in the second sale.

This rule would not apply to dispositions of the property (other than marketable securities) by the related purchaser more than two years after the first sale. Thus, the bill provides a bright line test designed to separate pre-arranged transactions from those which occur in the normal course of business. The running of the two-year period would be suspended, however, if the related purchaser substantially diminishes his risk of loss through a short sale, the holding of a "put" or similar transaction.

The bill recognizes that even the above narrowly focussed formulation may result in unwarranted acceleration of gain recognition to related sellers where dispositions by related purchasers are occasioned by unforseen events, economic necessity or do not result in the abuse the section is intended to cure. Thus, dispositions after the death of either the purchaser or seller, dispositions which occur by reason of an involuntary conversion where the initial sale occurred prior to the threat or imminence of the conversion, and sales by the issuing corporation of stock acquired from a related person are specifically excepted from the related party rules. In addition, if it can be established to the satisfaction of the Secretary that neither the first nor the second disposition has as one its principal purposes the avoidance of Federal income tax, the disposition may be exempted from this rule. Treasury will issue rulings and regulations describing categories of transactions which qualify for the latter exception, but it will not be necessary for taxpayers to obtain advance rulings in order to qualify.

The result is a rule Treasury believes to be fair. The parent who sells the family farm or closely held business interest to a child in a transaction structured to allow the child to pay for the interest over time is not affected by this rule so long as the child does not sell the acquired interest within two years. Thus, the rule will not cause problems for farms or businesses kept in the family.

Moreover, even if the related purchaser does sell within two years, gain will not be accelerated if one of the specific exemptions applies or tax avoidance was not a principal purpose of the transaction. Thus, ample flexibility exists to deal with difficult cases as they arise.

The related party rule will apply to installment sales occurring after March 31, 1980. This date gave sufficient notice after H.R. 6883 was introduced so that taxpayers should have been aware of its existence. Moreover, arguments to postpone the effective date should be viewed skeptically in light of the fact that any sales occurring after March 31, 1980, will not be subject to this rule unless income tax avoidance was a principal purpose of the transaction.

SECTION 337 LIQUIDATIONS

Under current law, a corporation generally recognizes no gain upon the distribution of installment obligations to its shareholders pursuant to a twelve-month liquidation under section 337, except for recapture and other similar items. However, shareholders are taxed upon receipt as having received a distribution equal to the fair market value of the notes.

This structure leads to disparate results at the shareholder level depending upon whether a corporation sells its assets for installment obligations and then liquidates under section 337 or the shareholder sells stock in the corporation for installment obligations. In one case, gain attributable to the unpaid installment obligation is accelerated; in the other, it is not.

The transaction in which Mr. Rushing engaged was designed to avoid precisely this anamoly. The bill recognizes the anamoly and eliminates the need for future Rushing type transactions in this area by providing that, in general, installment obligations received by corporations for assets sold after the date of adoption of a section 337 plan may be distributed to shareholders as liquidating distributions without gain acceleration.

SUMMARY

I have highlighted certain portions of H.R. 6883 for the Subcommittee's attention. I hasten to add that the bill clarifies and rationalizes the application of the installment

sale rules to like-kind exchanges, refines the definition of the disposition of an installment obligation and applies to executors and heirs the rules presently available for sellers who reacquire, in foreclosure, property sold for future payment.

It should be apparent from the foregoing that H.R. 6883 is an ambitious undertaking. Admittedly it does not address every problem in the area of sales for future payment. Issues such as the rationalization of the treatment of "collection gain" and a uniform definition of what constitutes "payment" are important and deserve continued study. However, time is needed for Congressional and Treasury staffs and for tax practitioners to analyze these additional areas.

In the meantime, it is important that the simplification process show some tangible results. We all advocate technical tax simplification. We also recognize that dramatic improvements cannot be achieved overnight. But unless results are assured, we cannot expect the professional tax community or the staffs to expend the necessary resources.

Mr. Chairman, we are grateful for the leadership you have taken in this effort. H.R. 6883 represents the concensus of many diligent and objective participants and we appreciate the fact that you and Mr. Duncan have co-sponsored the bill. We now urge expeditious favorable Subcommittee action on it.

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artment of the TREASURY NEWS
INGTON, D.C. 20220 TELEPHONE 566-2041

<u>For Release Upon Delivery</u>
Expected at 10:30 a.m.

STATEMENT OF
DANIEL I. HALPERIN
DEPUTY ASSISTANT SECRETARY
(TAX LEGISLATION)
BEFORE THE
SUBCOMMITTEE ON SELECT REVENUE MEASURES
OF THE
COMMITTEE ON WAYS AND MEANS

April 17, 1980

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to present the views of the Treasury Department on the following six bills: H.R. 5616, relating to the excise tax on wine used in distilled spirits products; H.R. 5729, allowing a deduction for new trade or business start-up expenditures; H.R. 6039, relating to the treatment of annuity contracts purchased by the Uniformed Services University of the Health Sciences; H.R. 6140, to prevent the abuse of certain pension plan provisions through the use of separate corporations or other organizations; H.R. 6247, to provide that, in certain cases where married individuals live apart, community property laws will not apply for Federal tax purposes, and H.R. 6824, to provide for the treatment of nonqualified deferred compensation arrangements maintained by tax-exempt organizations. These bills as a group raise a number of significant tax policy issues and we commend the Subcommittee for providing this opportunity to discuss the issues.

After setting out a summary and the position of the Treasury Department with respect to each bill, I will discuss each proposal in detail.

Summary

H.R. 5616 would reduce the effective excise tax rate on wine used in distilled spirits products to its pre-1980 level. The Treasury Department is strongly opposed to H.R. 5616.

H.R. 5729 would permit a taxpayer to elect to amortize certain business start-up costs that otherwise would not be deductible. The Treasury Department supports H.R. 5729.

H.R. 6039 would extend section 403(b) treatment to annuity contracts purchased by the Uniformed Services University of the Health Sciences. The Treasury Department is not opposed to H.R. 6039.

H.R. 6140 would require employees of entities providing services to professional corporatins to be included in qualified retirement plans established by such professional corporations. The Treasury Department supports H.R. 6140 and suggests consideration be given to a broader solution to potential abuses in this area.

H.R. 6247 would provide that community property laws would be disregarded for Federal income tax purposes if spouses live apart for an entire year and no income transfer is made between the spouses. The Treasury Department supports H.R. 6247, modified as described below.

H.R. 6824 would allow employees of tax-exempt organizations to individually elect to defer any amount of compensation without regard to the rules relating to qualified retirement plans. The Treasury Department is strongly opposed to H.R. 6824.

* * * *

H.R. 5616 -- Tax Status of Wine Used in Distilled Spirits Products

H.R. 5616 proposes to reverse one part of the thorough reform of the taxation of distilled spirits enacted as the Distilled Spirits Tax Revision Act of 1979 (Title VIII of the Trade Agreements Act of 1979). Under the 1979 Act, which was effective January 1, 1980, all distilled spirits products, domestic and imported, are taxed on their alcoholic content at a uniform rate of $10.50 per proof gallon at the time of removal from bond. This was not true of prior law.

One case where the prior tax deviated from a straight $10.50 rate involved the mixing of wine with distilled spirits to produce a distilled spirits product, most notably liqueurs, cordials, and so-called specialities. The wine was taxed at the low rate on wine when withdrawn from the winery, the distilled spirits used were taxed at the distilled spirits rate when withdrawn from the distilled spirits premises, and the mixture then was subject to an additional rectification tax of 30 cents a proof gallon. The net result was that some domestic liqueurs and cordials containing large amounts of table wine were taxed at an effective rate of $6.50 a proof gallon. This was true, however, only for domestic products. Imported alcoholic beverages were taxed on the proof gallon content, or wine gallon if below 100 proof. For example, a gallon of 80 proof whiskey imported in bottles was taxed at $10.50 instead of the $8.40 it would have been subject to if taxed on the proof gallon content.

H.R. 5616 seeks to restore the prior lower effective rate on the alcoholic content of wine used in distilled spirits products. It would grant the producers, or importers, of distilled spirits products containing wine a credit against the distilled spirits tax equal to the excess of $10.50 over the tax rate on the wine content that would have been imposed if the wine had been taxed as wine. Depending upon the tax classification of the wine, the credit could be as much as $9.89 per proof gallon of the wine. 1/ For domestic products the credit would be taken at the time wine is dumped for processing at a distilled spirits plant. The credit for imported products would be determined at the time the tax on the imports is determined; i.e., removed from bonded premises.

1/ This is as much as 2-1/2 times the cost of the wine to the distilled spirits producer.

The Treasury Department strongly opposes enactment of this bill for two reasons. First, the bill would defeat a major purpose of the Distilled Spirits Tax Revision Act of 1979, which is to tax distilled spirits products uniformly on the basis of alcoholic content. Second, the bill would create serious administrative problems in protecting the revenue, particularly with respect to imported products.

The Treasury Department strongly supported the change to taxing distilled spirits products on the basis of their alcoholic content because it believes that it is only reasonable that producers and consumers of all domestic distilled spirits products be taxed on a uniform basis measured by alcoholic content. The fact that part of the alcohol in a distilled spirits product is derived from wine should not be reflected in a lower tax than if the alcohol were produced only from grain. Consumers of liqueurs, cordials, and so-called specialities no longer can obtain the alcohol at a lesser tax rate than highball consumers. Of course, the change caused some increase in the cost of products formerly taxed at less than $10.50 a proof gallon, but this is a necessary result of the desired objective.

The taxation of alcohol in wine used in distilled spirits products at the distilled spirits tax rate was not an unintended result of the 1979 legislation. The Ways and Means Committee, in reporting on that legislation, expressed support for the all-in-bond system and the resulting changes in the method of determining the tax on distilled spirits as an improvement in the distilled spirits tax system. 2/ The Committee also specifically noted that the new system of taxation would have the result "that domestic products as well as imported products will now be taxed on the basis of the alcohol content of the finished product after it has been diluted and bottled and will include the part of the alcohol content which is derived from _wine or other alcoholic ingredients_ added to a _distilled spirits product before it is bottled._" 3/

The importance to the domestic wine industry of the changed method of taxing distilled spirits is extremely minor. Wine is not used in distilled products merely to save on the excise tax. Many products contain wine as a basic flavoring ingredient. If the producers do not want to have to educate their customers to a new taste,

2/ H.R. Rep. No. 96-317, 96th Cong., 2d Sess. 162 (1979).

3/ _Id_. at 164, emphasis added.

they will continue to use the same, or approximately the same, amount of wine. There are some products, of course, where wine is heavily used to minimize tax. These formulas might well be changed somewhat under the new law. But whatever the change, it can hardly loom large for the wine industry.

According to our statistics, only 403,000 proof gallons of wine and vermouth were used in domestic distilled spirits products in fiscal year 1979. This represents less than 2 million wine gallons. In the same 1979 fiscal year, withdrawals of domestic still wine, both taxable and tax-free, were 395 million gallons. Use of wine in distilled spirits products thus was about one half of one percent of total withdrawals.

The proposal in H.R. 5616 obviously does not represent a great deal of revenue. For domestic products, the revenue loss appears to be about $5 million based on recent practice in the industry. We do not have an estimate of how much the revenue loss would be for imported products. Our objection to the bill thus goes beyond the particular revenue figure. The change in the law that resulted in the taxation of distilled spirits products containing wine on a proof gallon basis also taxed on the same basis domestic products containing alcoholic flavoring materials and all alcoholic beverages imported at below 100 proof. We consider this equalization as a major step forward. The return to an unequal level of taxation as proposed by H.R. 5616 would represent a step, perhaps the first step, back to a system that is less than equitable. As a matter of fact, the flavoring material producers wish a return to the old system as it affected them if wine producers are granted the change proposed by the bill.

Under prior law, it was possible to reduce the effective rate of tax on distilled spirits products by using a small amount of flavors or flavoring materials containing alcohol taxed at $1 a proof gallon because they qualified as being "unfit for beverage purposes." If wine producers are to be given a tax advantage as proposed by H.R. 5616, it is hard to argue that producers of flavoring materials should not also benefit from a return to the old system.

Administrative problems posed by the bill would be most apparent in its application to imported products. The tax on wine varies depending on its alcoholic content. For example, the tax on wine which does not exceed 14 percent alcohol by volume is 17 cents per gallon, and the tax on wine over 14 percent but not exceeding 21 percent by volume is 67 cents per gallon. Therefore, in order to determine the credit due on

imported products under H.R. 5616, it would be necessary to know both the quantity and alcoholic content of wine used in the product. The laboratory of the Bureau of Alcohol, Tobacco and Firearms has advised us that it is technically impossible to analyze a finished distilled spirits product to determine the quantity and alcoholic content of wine which may have been added. Consequently, there is virtually no way in which ATF could verify claims made by importers under the bill. Since the tax credit in question is almost $10.00 per proof gallon of wine our inability to verify claims would pose a serious jeopardy to the revenue.

Any amendment to the bill to eliminate the credit for imports while retaining the credit for domestic products would be inconsistent with the purpose of the Trade Agreements Act, since it would constitute a nontariff trade barrier of the type we have objected to when imposed by foreign countries.

With respect to the credit for domestic distilled spirits products, the bill also presents administrative and technical problems. Presumably, the theory for the credit provision is that the wine will eventually leave the distilled spirits plant taxed at the distilled spirits rate. However, the bill does not require this as a condition to the credit. A credit is allowed regardless of whether the wine is ever taxed as distilled spirits. In fact, products containing wine could, for example, be exported or destroyed without being subjected to the distilled spirits tax. In addition, the bill permits the credit to be taken at the time the wine is received at the distilled spirits plant, but the tax is not paid until the final product leaves the plant. Thus, the bill provides for the credit before the tax is paid.

Further, one of the major purposes of the Distilled Spirits Tax Revision Act of 1979 was to simplify the tax system and the regulation of distilled spirits plants. However, H.R. 5616 would complicate the administration of the distilled spirits tax by reimposing on distilled spirits producers the requirement to maintain records showing the proportions of wines and distilled spirits in each product and the quantities shipped. It would also create additional oversight problems for ATF and thus diminish one of the chief advantages of the Government from implementation of the all-in-bond system enacted by the 1979 law.

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H.R. 5729 -- Amortization of Start-Up Expenditures

H.R. 5759 would permit a taxpayer to amortize over a period of five years or longer certain business start-up costs that otherwise would not be deductible. The costs that may be amortized under the bill are those costs paid or incurred prior to the functioning of the business as a going concern and that are incident to the investigation, formation, or creation of a business which is actually entered into by the taxpayer. The costs may not create an asset having a useful life of its own; they must be of a character that would be subject to amortization over the life of the business (and not the life of some other asset) if the business had a determinable useful life. Typical of these costs are the investigatory expenses directly related to the particular business, and the appraisals, advertising insurance, utilities and other routine expenditures paid or incurred prior to the actual commencement of the business.

For the following reasons, we support H.R. 5729.

The bill is designed to reduce the disparity in tax treatment between certain ordinary and necessary preopening expenses and similar expenses incurred by an existing business. Under current law, most preopening expenses are neither deductible nor subject to amortization, but similar expenses incurred by a going concern are currently deductible in most cases. It is difficult to justify such disparate treatment for similar expenses.

The problem of start-up costs arises not only for taxpayers entering their first business, but also for taxpayers with an existing business upon beginning a new business that is unrelated or only tangentially related. The tax treatment of the start-up costs of a related business has generated much controversy. Under current law, these costs are currently deductible if the new operations are part of the existing "trade or business" and the costs do not create a separate asset; costs must be capitalized, however, if the new operation constitutes a separate trade or business. The many controversies between taxpayers and the Internal Revenue Service on this issue reflect (1) the difficulty in many cases of determining what constitutes a new business and when a new asset is created, and (2) the consequences of the determination. Depending on where these lines are drawn, the start-up costs are either deductible in full or must be capitalized indefinitely.

It is our hope that enactment of this bill will induce taxpayers with existing businesses to elect to amortize the start-up costs of a marginally related business, thereby reducing the number of controversies in this area. In the unclear cases, of which there are many, taxpayers should elect to amortize; if they fail to elect and the Internal Revenue Service successfully maintains that the costs must be capitalized, the election would not be available and the costs would not be recoverable through amortization. 1/ Electing to amortize these expenses over five years would appear for most taxpayers to be a more prudent decision.

In summary, we support H.R. 5729 because it would (1) reduce the disparity in tax treatment between certain ordinary and necessary preopening expenses and similar expenses incurred by an operating business, and (2) tend to reduce the number of controversies between taxpayers and the Internal Revenue Service, especially where a taxpayer begins a related business.

* * * *

H.R. 6039 -- Annuity Contracts for Uniformed Services University of the Health Sciences

Under current law, an employee of a tax-exempt organization described in section 501(c)(3) of the Code, or an employee of a public school system, may participate in a tax-exempt salary reduction annuity plan. In general, employer contributions for the purchase of an annuity contract under such a plan are excludable from the employee's gross income and are not subject to tax until the employee receives payments under the annuity.

1/ This is based on the assumption that the bill is clarified to require that the election must be made not later than the time prescribed by law for filing the return (including extensions thereof) for the year the expense was paid or incurred. A provision of this nature would be necessary, in our view, to achieve one of the major virtues of this bill.

H.R. 6039 would extend the availability of these tax-exempt salary reduction annuity contracts to the civilian faculty and staff of the Uniformed Services University of the Health Sciences. We understand that the bill is intended to allow this University to attract civilian faculty and staff by offering retirement benefits and salary reduction plans similar to those given to the faculty and staff of medical schools which are tax exempt or which are part of a public school system.

H.R. 6039 is substantially identical to a number of bills which have been introduced in this and the previous session of Congress. As we have previously testified, the Treasury Department does not believe that section 403(b) represents sound tax policy. However, in the context of present law, the Treasury Department does not oppose H.R. 6039.

We do request a change in the effective date of the bill, however. H.R. 6039 provides that it will apply to service performed after December 31, 1979, in taxable years ending after such date. We do not believe it is appropriate to provide for a retroactive effective date, and we suggest revising H.R. 6039 so that it is effective with respect to services performed after the date of enactment in taxable years ending after such date.

* * * *

H.R. 6140 -- Aggregation of Professional Organizations for Retirement Plan Qualification

H.R. 6140, which we suport, is concerned with efforts by some individuals to avoid qualified plan coverage of rank-and-file employees. This is ostensibly achieved by establishing two entities, one which employs a limited number of key employees and another which employs the rank and file. Only the key employee entity adopts a qualified retirement plan.

Before enactment of the Employee Retirement Income Security Act of 1974 ("ERISA"), it may have been possible to achieve this result merely by creating two or more corporations within a controlled group of corporations and establishing a qualified plan for employees of only one member corporation. For example, if a manufacturing company established a parent corporation which employed only management employees and a wholly-owned subsidiary which employed all others, a plan could have been adopted by the parent corporation solely for the management employees.

ERISA amended the Internal Revenue Code to prevent this abuse by requiring an aggregation of controlled group members for purposes of testing the qualified status of any plan adopted by a member of the group. In other words, for qualified plan purposes, the employees of all members of a controlled group of corporations are treated as if they were employed by a single employer; in effect, a fictional umbrella employer is assumed.

The legislative history of these rules shows they were intended to "make it clear that the coverage and antidiscrimination provisions cannot be avoided by operating through separate corporations instead of separate branches of one corporation." 1/

However, it is now apparent that the current rule alone will not prevent outright avoidance of Congressional intent in this area.

Description of Problem

A body of practice is developing which is aimed at excluding rank-and-file employees from coverage in qualified plans. One approach is to arrange the ownership of related entities in an artificial manner so as to avoid the literal definition of a controlled group. Another approach is to contract with an unrelated "service corporation" to supply non-management or non-professional personnel. For qualified plan purposes, these individuals are treated as employees of the service corporation rather than the organization for which they actually perform services. Although these schemes are seen particularly in the area of professional corporations, they are not limited to professionals.

Avoiding Controlled Group Status

In the area of avoiding the controlled group aggregation rules, the focus by key employee corporations has been on the use of brother-sister entities. Under the Code, businesses in a

1/ H.R. Rep. 93-807, 93d Cong., 2d Sess. 50 (1974).

brother-sister relationship are aggregated for plan purposes only if five or fewer persons own more than 50 percent of the stock or other equity in two or more businesses. For this purpose ownership by an individual is counted only to the extent of the lower degree of ownership in the two businesses being tested.

The scheme to avoid these rules, and the reasons for engaging in the scheme, can be best illustrated by an example.

Assume Smith and Jones are equal partners in the practice of law. If they adopt an H.R. 10 plan, the maximum deductible contribution for each of them under the plan would be $7,500. If they form a professional corporation, the maximum deductible contribution for each of them will be in excess of $30,000. 2/

However, in either case, they would also be required to make similar contributions (or provide similar benefits) under the plan for associate lawyers, secretaries and other personnel.

To avoid this result, Smith and Jones separately incorporate their law practices and provide that the Smith professional corporation employs only Smith and the Jones professional corporation employs only Jones. Each professional corporation adopts one or more qualified plans providing the maximum permissible benefits for the only covered employee, respectively Smith and Jones.

Since Smith and Jones still need assistance to practice law they must provide for support personnel notwithstanding their separate professional corporations. Therefore, they form a new partnership, not as individuals but in their corporate capacities -- a partnership of corporations. The partnership employs the administrative (secretaries, receptionists) and support (associate lawyers) personnel. Because neither

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2/ It has been argued that elimination of the difference in maximum contributions between H.R. 10 and corporate plans would also eliminate the manipulation of brother-sister entities. However, as noted below, the principal reason for establishing the artificial entity relationships is to limit plan coverage and equalizing the maximum contribution rates would not terminate this opportunity.

Smith nor Jones has a more than fifty percent interest in the partnership, the partnership is not, under a literal reading of the Code, a member of a group of commonly controlled trades or businesses with either professional corporation. The Tax Court has recently held 3/ that the requirement of aggregation of employees for purposes of meeting the qualified plan rules does not apply here, and that plans established by the Smith and Jones professional corporatons need not provide coverage for the partnership employees.

Service or "Loan-Out" Corporations

Another scheme for excluding rank-and-file employees from the qualified plans of key employees and professionals involves the use of a "service" or "loan out" corporation which is operated by an unrelated party. This approach is intended to insulate the key employee or professional from the rank and file by characterizing the rank and file as employees of the service corporation, not of the key employee or professional corporation. The service corporation scheme is an attempt to reach the same result as the partnership of corporations described above without involving more than one key employee or professional.

Generally, the Internal Revenue Service has taken the position that employment for qualified plan purposes is the same as employment for such public programs as the Federal Insurance Contributions Act ("FICA"). Thus, if an individual is treated as an employee of an employer for FICA purposes, the employee is also treated as an employee of that employer for qualified plan purposes even if the employee performs substantial services for some other person or entity. Thus, where a "loan-out" agency provides service personnel, even on an ongoing basis, the Internal Revenue Service has generally taken the position that the individuals

3/ Lloyd M. Garland, M.D., F.A.C.S., P.A., 73 T.C. ____, No. 1 (October 4, 1979).

providing services are employees of the loan-out agency, not of the entity for whom they provide services. 4/

In these cases, the form of the employment agreement is raised over the substance of the working relationship, and the antidiscrimination coverage principles of qualified plans are avoided.

Purposes of Plan Coverage Requirements

Generally, under an income tax system, income is subject to tax when earned, whether it is consumed immediately or put aside for a rainier day. Tax incentives for retirement savings work to defer tax until income is spent, presumably after retirement. This departure from the goal of a progressive income tax system can only be justified as a means of furthering non-tax social policy goals. We believe the goal in the case of retirement plans is the assurance that employees at all levels of compensation will be provided with retirement protection, protection which is particularly difficult to plan and save for at lower income levels. As evidence of this goal, favorable tax treatment is generally allowed only if the plan covers a substantial number of employees of the employer and contributions or benefits provided by employer contributions do not discriminate in favor of officers, shareholders and highly-compensated employees. The Congress gave additional recognition to this policy in providing the controlled group rules described above.

4/ Use of this approach was slowed somewhat after the Tax Court decision in Edward L. Burnetta, O.D., P.A., 68 T.C. 387 (1977). In Burnetta, services were performed for two professional corporations by individuals whose "records" were maintained, and who were paid, by a service corporation. The Tax Court found that because of the relationship between the professional corporations and the workers, the workers were employees of the professional corporations, not the loan-out corporation. Based on this finding, the plan of one of the professional corporations was held to be nonqualified.

However, notwithstanding the result in Burnetta, we understand that a number of practitioners continue to use the service corporation approach but with a more carefully designed relationship among the professional or key employee corporation, the service corporation and the workers.

Without these nondiscrimination requirements in plan coverage and in contributions and benefits, the tax system would be ill-equipped to achieve the social goal of providing retirement income to a reasonably broad range of individuals, particularly with respect to those with low or moderate income. The higher a taxpayer's income, the greater the benefits of favorable tax treatment. Such persons are also more likely to save. Low income employees may well opt for current compensation in lieu of retirement protection. The tax benefit alone is insignificant to them and not enough to change their choice. This explains the continuing efforts by some employers to limit their retirement plans to those at high income levels. Despite the fact that the goal of limiting participation is inconsistent with the policy of the nondiscrimination requirements, their effort may succeed in the absence of a requirement that employees providing services to an employer must participate in any tax-favored retirement plan.

This follows both where ownership of related entities in manipulated to avoid aggregation and where individuals are nominally "employed" by a "loan-out" agency but perform services for others on a continuing basis.

<u>H.R. 6140</u>

H.R. 6140 would affect professionals who arrange their business to avoid the statutory definition of a controlled group by requiring the aggregation, for qualified plan purposes, of a professional organization and any "adjunct professional organization" if:

(1) the professional organization regularly uses the services of, or is regularly associated in performing services with, the adjunct professional organization; and

(2) certain minimum ownership tests are satisfied.

For purposes of this provision, an adjunct professional organization is an organization where the employees perform services for persons who perform professional services. For example, the secretaries and other administrative personnel in a law office would constitute an adjunct professional organization if they were employed by an entity separate from the lawyers performing professional services.

H.R. 6140 would eliminate the most common type of abuse in this area. For example, two professionals would no longer be able to avoid covering rank-and-file employees in a retirement plan by separately incorporating and forming a partnership to hire the rank and file.

We wish to note what we believe is a minor, technical problem with the bill. As noted above, the professional and adjunct organizations are subject to certain minimum ownership tests before aggregation is required. As drafted, one of these tests requires an ownership interest by the professional in the adjunct organization. While the bill also provides for applicaton of the principles in section 267, relating to transactions between related parties, in determining ownership, the attribution rules in section 267 do not require attribution of any non-corporate interest held by a corporation to its shareholders. Thus, to use the example of lawyers Smith and Jones above, the Smith and Jones corporations hold interests in the adjunct partnership and there would be no aggregation under the bill as drafted since neither lawyer individually owns an interest in the partnership and the partnership interests of the professional corporations would not be attributed to the individual lawyers. We hope this problem can be dealt with in drafting a final version of the bill.

Treasury Position

We believe H.R. 6140 may not be broad enough to completely eliminate the problem with which it deals. However, we want to emphasize that we agree with the need to remedy the abuses in this area, and we support H.R. 6140 which curtails the most blatant abuse. To the extent the suggestions below will require further study by the Subcommittee which would substantially delay passage of remedial legislation in this area, we support the immediate passage of H.R. 6140 with an understanding that we will continue to work with the Congress to fashion broad remedies to the remaining forms of abuse.

The two areas where we wish to discuss a broader approach relate to: (1) the scope of affected employers, and (2) the treatment of individuals performing services under an arrangement with a "loan-out" company.

Scope of Affected Employers

H.R. 6140 limits its aggregataion rules to those situations where professional services are provided. For this purpose, professional services include services performed by physicians, dentists, chiropractors, osteopaths, optometrists, other licensed practitioners of the healing arts, attorneys at law, public accountants, public engineers, architects, draftsmen, actuaries, psychologists, social or physical scientists, and performing artists.

While we agree that current case law 5/ indicates that the controlled group abuse is most prevalent in the professions, other individuals who do not perform professional services will also undoubtedly take advantage of these cases. We believe the abuse should be curtailed generally, and therefore recommend revision of the bill to allow aggregation of related organizations in any appropriate circumstance, not solely where one of the organizations is providing professional services.

"Loan-out" Corporations

H.R. 6140 does not address the abuse arising in the "loan-out" area, and we wish to open a dialogue with the Subcommittee to consider legislative provisions to cover this problem.

As noted above, the Internal Revenue Service has generally held that an individual's status as an employee for employment tax purposes (*e.g.*, for Federal Insurance Contribution Act (FICA) taxes) is determinative of the individual's status for qualified plan purposes. Thus, if an individual is considered an employee of a service or "loan-out" corporation for FICA purposes, he or she is considered an employee of the loan-out corporation for plan purposes and is *not* considerd an employee of the corporation where the individual is "temporarily" assigned. Historically, the Internal Revenue Service has not recognized that an individual may be an employee of two employers with respect to the same services for qualified plan purposes.

This approach makes sense from the viewpoint of payroll tax administration since it is crucial to the Service's revenue collecting role that there be a readily identifiable source for the collection and payment of employment taxes. Where an individual performs temporary services for many organizations, it is also helpful to have a single source for the collection (and reporting) of employment taxes.

However, we do not believe it is necessary to ignore the potential of dual employment in the qualified plan area in order to achieve certainty in the area of employment tax collection. It seems that in many cases involving "temporary" help or services, the individuals involved are in an employee-employer relationship with

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5/ *See*, *e.g.*, *Lloyd M. Garland*, *M.D.*, *F.A.C.S.*, *P.A.*, 73 T.C. ____, No. 1 (1979); *Thomas Kiddie, M.D., Inc.*, 69 T.C. 1055 (1978).

the organization which has contracted with the service corporation or "loan-out" agency. For example, if an agency provides secretarial help to a business office, it is likely that the business office will actually exercise control over the performance of the secretary's services and will generally establish, among other things, the manner in which the work is to be performed. This is particularly true when the "temporary" worker stays in the same job for an extended period. In such a case, we do not believe the substance of the relationship between the individual and the office is acccurately reflected by adherence to a mechanical rule which holds that an individual's status for employment tax purposes is determinative. We believe that it would be appropriate to treat the individual in this case as an employee of the office for qualified plan purposes.

We have begun a review with the Internal Revenue Service of the issues involved in the Service's historical approach to determining whether an individual is an employee for qualified plan purposes. We believe the historical approach may be changed administratively, and we are considering the available options in this regard. However, we recognize that there are limitations inherent in proceeding on such a course through regulations or other rule making and we appreciate this opportunity to open a dialogue with the Congress which will hopefully lead to a satisfactory solution to this problem area.

One possible approach would be to require that employers count the hours of service of "temporary" service employees in determining eligibility, etc., under the employer's plan. Section 410 allows the exclusion from a plan of any employee who has not completed a year of service, and a year of service is generally defined as completing 1,000 hours of service in a 12-month period. Assuming the plan uses a 10-hour-per-day "equivalency" method for crediting hours of service, the "temporary" employee would need to perform services for the employer for 100 days before any question of plan eligibility arose. Since there are only about 250 working days in a year, it does not seem that such an approach would work an undue burden on plans.

We would appreciate the opportunity to pursue this matter and other options which may be available with the Subcommittee and staff. However, as noted above, we do not want to delay the passage of H.R. 6140 solely to give additional consideration to this issue.

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H.R. 6247 -- Married Individuals Living Apart But Subject to Community Property Laws

Under community property law, income received by a spouse during the marriage (other than income from a class of property characterized as separate property) legally belongs one-half to each spouse. Certain Federal income tax consequences flow from this fact. For example, spouses who file separate returns in a community property state are each required to include on that return one-half the community income. In common law jurisdictions, if spouses file separately, each reports only the income attributable to his or her own efforts, or from property owned by the spouse.

In a community property state, a spouse who has been abandoned must report and pay tax on one-half the community income. The income must be reported even if the abandoned spouse has no way of knowing of the existence, or amount of the income, and has little or no practical way of paying tax. This result could not occur in a common law state. In such a state, an abandoned spouse would be required only to file a return and pay taxes on income actually earned (or from property actually owned) by the spouse. Moreover, the present innocent spouse provisions offer no relief to the abandoned spouse in the community property state because that provision applies only when a joint return is filed. As a result, there have been cases in which a wife was held liable for the tax on income earned by the husband even though she had received no benefit from the income and had only modest assets of her own.

Under H.R. 6247, if spouses are living apart for the entire year, and no earned community income is transferred between the spouses, community property income will be taxed in accordance with common law principles. Thus, this bill will remedy some of the problems of spouses in community property states. But we think that the relief can and should be broader.

First, the bill does not clearly grant relief for all community income. An abandoned spouse has no greater access to or information about passive investment income than he or she may have about earned income or income from a trade or business. We recommend expansion of this provision to include all community income.

Second, no relief is available if the abandoned spouse has received as little as one dollar of the other spouse's earned income. We recommend that the bill be amended to provide that if any property is transferred between the spouses, that the recipient spouse be taxed on that amount, with a corresponding exclusion from income for the other spouse. The bill should also provide that all property received by a spouse will be deemed to be income. In the absence of such a rule the abandoned spouse could argue that the property transferred was in the nature of a property settlement and was therefore not taxable as income.

Third, the bill only offers relief when both spouses have earned income which is community income. We see no reason for this requirement. Even if the abandoned spouse has no earned income, he or she should be entitled to relief.

If the bill is expanded to provide relief as outlined above, certain technical modifications would be required. To eliminate the potential for abuse, and collusion between spouses for the purpose of effecting advantageous income splitting (something not available to common law spouses, who if they file separately are liable for tax only on the income attributable to each), relief should only be available if justified by the facts and circumstances. Additionally, if relief is given for all community income, the bill must be modified to insure that all income is properly attributed (generally by analogy to common law principles).

Even if these changes in the scope of H.R. 6247 are not made, there are two problems with H.R. 6247 that should be remedied. As presently drafted, the bill is mandatory. Thus, if the conditions are satisfied, income must be divided in accordance with essentially common law rules. Community property spouses who live apart must report their income as prescribed in the bill. There may well be circumstances in which a husband and wife are separated but still wish to file separate returns, each reporting one-half the community income. They are permitted to do so under present law. They should continue to have this option.

Also, the bill should clearly state that when the abandoned spouse is relieved of liability for tax on any income other than that which has been received, the balance of the income is to be reported by the other spouse.

We would like to point out that other similar problems are not addressed in the bill. The bill does not apply in the year the spouses separate. Nor does it apply where a husband or wife are living together, and one spouse deprives the other of his or her share of community income, even if the deprived spouse may be completely unaware of the income and receive no benefit from it. We are studying these problems. However, they are very difficult and we are not confident they can be solved. In the interim, we support H.R. 6247 and recommend that the changes outlined above be adopted.

* * * *

H.R. 6824 -- Treatment of Nonqualified Deferred Compensation Arrangements of Tax-Exempt Employers

H.R. 6824 would provide that the year of income inclusion for amounts subject to a nonqualified deferred compensation arrangement maintained by a tax-exempt employer would be determined under the principles applicable to deferred compensation arrangements in effect on February 1, 1978. This would allow employees of tax-exempt employers to individually elect to defer any amount of compensation without regard to the rules relating to qualified retirement plans. The Treasury Department is strongly opposed to H.R. 6824.

On February 3, 1978, the Internal Revenue Service published proposed regulations which would have applied the doctrine of constructive receipt to all arrangements where employees have an individual option to defer the payment of compensation. In many cases, these arrangements were provided in lieu of a qualified, funded retirement plan. Because the deferral option could be provided selectively to highly-compensated employees and the benefits of deferral were then subject to the employee's election, the availability of such arrangements decreased the likelihood that an employer would establish a funded, qualified retirement plan covering all classes of employees.

The Revenue Act of 1978 prevented the application of the rules in the proposed regulations to employees of a <u>taxable</u> entity. Taxable entities were exempted from the proposed rules because an employer's deduction for compensation is postponed until the deferred amount is included in the employee's income. This deduction deferral will, in many cases, make a nonqualified plan of deferred compensation less attractive than a qualified plan. However, this result does not follow in the case of a <u>tax-exempt</u> employer where there is no deduction for the payment of wages.

Accordingly, the 1978 Revenue Act provision exempting taxable entities from the proposed regulations did not extend the same treatment to tax-exempt organizations. We believe this distinction is justified and we oppose the effort in H.R. 6824 to extend the treatment of taxable employers to tax-exempt employers.

Looking solely at the issue of incentives to establish a qualified retirement plan, the tax-exempt employer gains no benefit from the deductibility of wages and is generally exempt from tax on its own income, so that the cost to the tax-exempt employer of a qualified plan is no less than the cost of providing the same benefit to an individual employee under a nonqualified plan. 1/ Thus, there is little, if any, tax encouragement at the employer level for a tax-exempt organization to adopt a qualified plan.

Perhaps more disturbing, under Title I of ERISA if a nonfunded plan is maintained, it may only provide benefits primarily for a select group of management and highly-compensated employees. Therefore, if a tax-exempt employer is in a tax-neutral position between qualified and nonqualified plans, this will, in effect, encourage and in some cases require the discriminatory provision of retirement benefits.

We would also like to answer one other argument which has been raised in this area. It is often stated that the deduction for wages available to a taxable employer reduces the cost to the employer to 54 cents on the dollar. However, this is only true if the corporation pays compensation out of what would otherwise be after-tax profits. A corporation entering a particular activity must expect to earn enough to cover its costs (including salaries) plus an adequate return on its investment, after taxes. Thus, if the net return is to remain constant, an additional one dollar of gross revenue must be received for each additional one dollar of compensation payable if the payment is deductible; if

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1/ Under one set of assumptions, the annual after-tax cost to a taxable employer to provide a $100 annuity for one employee changes from $183 to $114 if a qualified plan is used rather than a self-funded investment pool. This is a reduction of 38 percent and tends to encourage the use of qualified plans by taxable employers. However, the cost to the tax-exempt employer of funding one employee's benefit is the same under either a qualified or a nonqualified plan.

not deductible, the additional revenue must be sufficient to cover both the tax on the income and the amount of the nondeductible payment. 2/ Therefore, the "54 cent dollar" argument is not persuasive.

There are two other ways to deal with the treatment of nonqualified arrangements provided by tax-exempt employers: through regulations or a different legislative approach. In the regulatory area, the Internal Revenue Service published a news release in June of last year seeking further comments on the February 3, 1978 proposed regulations as they would relate to employees of tax-exempt organizations. A public hearing was held at the Internal Revenue Service on November 27, 1979.

Comments were submitted in writing and at the hearing regarding the standards to be used and the evidentiary problems which may arise in determining the existence of a deferral option for employees of tax-exempt employers. We have given considerable thought to these comments.

We recognize that proceeding on a course of rulemaking by regulation has its limitations. Therefore, we are also considering a legislative proposal, S. 511, introduced by Senator Matsunaga on March 1, 1979, which would apply the same limitations on

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2/ For example, assume Corporation X buys widgets for $100 and wants a 10 percent after tax return on its investment. X must sell the widgets at a price sufficient to provide a return of $10 after costs and taxes. If the only cost involved is a $5 commission to the widget salesperson, and if X is entitled to deduct that payment in computing its taxes, then the price charged for the widgets will reflect only the $5 cost. However, if the $5 of compensation is not deductible, then, if the return is to remain at $10, X must raise the price of the widgets to cover both the compensation payment and the tax due on that payment. Of course, the status of the compensation payment as a deductible or nondeductible item would not matter if X could claim tax-exempt status since in that case, no additional amount would be needed to pay any taxes. A detailed explanation of this analysis is attached as Appendix A.

nonqualified deferred compensation for tax-exempt organizations as are currently provided for the nonqualified arrangements of State and local governments. We believe the status of tax-exempt employers is more appropriately analogized to State and local governments than to taxable employers since State and local governments are also tax exempt. Certainly there is no reason to favor high-income employees of tax-exempt organizations over rank-and-file employees of State and local governments.

The limitations on the use of nonqualified deferred compensation arrangements for individuals furnishing services to State and local governments were added by the Revenue Act of 1978 as section 457 of the Internal Revenue Code. These rules limit the percentage of compensation which may be deferred as well as the absolute dollar amount of the deferrals. Although these limitations clearly mitigate the disproportionate benefit under such arrangements previously available to highly compensated individuals, neither section 457 nor S. 511 would provide specific antidiscrimination rules for these plans. This is in contrast to the nondiscrimination tests provided in the 1978 Revenue Act for other salary reduction deferred compensation arrangements.

On the other hand, because section 457 places limits on the total amount which may be deferred, whether or not an employee exercises an individual option, evidentiary problems in establishing whether or not a deferral option exists would be avoided under this approach.

We continue to believe that section 457 would be improved by incorporation of nondiscrimination requirements, but we are also interested in continuing to explore the possibility of a legislative solution to this problem along the lines of S. 511. While we are proceeding with preparation of a final regulation relating to deferred compensation arrangements for employees of tax-exempt organizations, we will not publish such a regulation until we have had a further opportunity to pursue possible legislative solutions with this Subcommittee and other interested members of the Congress.

* * * *

I will be glad to answer any questions you may have.

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APPENDIX A

Explanation of Effect of Deduction for Compensation

Corporation X buys widgets for $100 and wants a return of $10 after tax. Assuming 50 percent tax rate and that $5 of compensation to the widget salesperson is the only xpense involved, the price of the widgets where the compensation is deductible or ondeductible (and where X is tax exempt) will be as follows:

	TAXABLE				TAX-EXEMPT
	Compensation Deductible		Compensation Not Deductible		
Sales Price		125		130	115
Costs & Expenses		105		105	105
Before Tax Income		20		25	10
Taxable Income	20		30		--
Tax at 50%	10		15		--
Return		10		10	10

partment of the TREASURY NEWS
IINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. April 17, 1980

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $4,000 million, of 359-day Treasury bills to be dated April 29, 1980, and to mature April 23, 1981 (CUSIP No. 912793 6A 9). This issue will provide about $1,000 million new cash for the Treasury as the maturing issue is outstanding in the amount of $3,020 million, including $276 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $ 1,073 million currently held by Federal Reserve Banks for their own account.

The bills will be issued for cash and in exchange for Treasury bills maturing April 29, 1980. Tenders from Federal Reserve Banks for themselves and as agents for foreign and international monetary authorities will be accepted at the weighted average price of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. This series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Standard time, Wednesday, April 23, 1980. Form PD 4632-1 should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders, the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held at the close of business on the day prior to the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for $500,000 or less without stated price from any one bidder will be accepted in full at the weighted average price (in three decimals of accepted competitive bids.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on April 29, 1980, in cash or other immediately available funds or in Treasury bills maturing April 29, 1980. Cash adjustments will be made for differences between the par value of maturing bills accepted in exchange and the issue price of the new bills.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

ıartment of the TREASURY

ıNGTON, D.C. 20220 TELEPHONE 566-2041

NEWS

FOR IMMEDIATE RELEASE
April 18, 1980

CONTACT: GEORGE G. ROSS
(202) 566-2356

UNITED STATES AND REPUBLIC OF MALTA SIGN INCOME TAX CONVENTION

The Treasury Department announced today the signing of an income tax Convention between the United States and the Republic of Malta in Valletta, Malta on March 21, 1980. There is presently no such agreement in force between the two countries. The Convention is being submitted to the Senate for its advice and consent to ratification.

The primary objective of the Convention is to promote economic relations between the two countries and to remove tax barriers to the flow of goods, investment and technology and the movement of businessmen, technicians and scholars. The Convention establishes rules for the taxation of business, personal service and investment income earned by residents of one country from sources in the other. The Convention provides also for non-discriminatory tax treatment and reciprocal administrative cooperation to avoid double taxation and prevent fiscal evasion.

The proposed Convention with Malta is similar in most essential aspects to other recent United States income tax conventions. There are several variations which, in general, either reflect Malta's status as a developing country or are designed to accommodate particular features of Malta law.

The Convention will enter into force upon the exchange of instruments of ratification. The provisions of the Convention will take effect in respect of income or profits arising on or after the first day of January of the year in which the Convention enters into force.

Attached is a copy of the Convention and of an exchange of letters, also signed on March 21, 1980, relating to certain provisions of the Convention.

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AGREEMENT BETWEEN

THE UNITED STATES OF AMERICA

AND

THE REPUBLIC OF MALTA

WITH RESPECT TO TAXES ON INCOME

AGREEMENT BETWEEN
THE UNITED STATES OF AMERICA

AND

THE REPUBLIC OF MALTA
WITH RESPECT TO TAXES ON INCOME

THE GOVERNMENT OF THE UNITED STATES OF AMERICA

and

THE GOVERNMENT OF THE REPUBLIC OF MALTA

DESIRING to conclude an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income

HAVE AGREED AS FOLLOWS:

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Article 1

Personal Scope

(1) Except as otherwise provided in this Agreement, this Agreement shall apply to persons who are residents of one or both of the Contracting States.

(2) This Agreement shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded:

(a) by the laws of either Contracting State, or

(b) by any other agreement between the Contracting States.

(3) Notwithstanding any provision of this Agreement, except paragraph (4) of this Article, a Contracting State may tax its residents (as determined under Article 4 (Fiscal Residence)), and by reason of citizenship may tax its citizens, as if this Agreement had not come into effect.

(4) The provisions of paragraph (3) shall not affect:

(a) the benefits conferred by a Contracting State under Articles 24 (Relief From Double Taxation), 25 (Non-Discrimination), and 26 (Mutual Agreement Procedure); and

(b) the benefits conferred by a Contracting State under Articles 20 (Government Service), 21 (Teachers), 22 (Students and Trainees) and 28 (Diplomatic Agents and Consular Officers) upon individuals who are neither citizens of, nor have immigrant status in, that State.

Article 2

Taxes Covered

(1) This Agreement shall apply to taxes on income imposed on behalf of a Contracting State.

(2) The existing taxes to which this Agreement shall apply are:

(a) in the United States: the Federal income taxes imposed by the Internal Revenue Code and the excise tax imposed on insurance premiums paid to foreign insurers and the excise taxes with respect to private foundations;

(b) in Malta: the income tax, including prepayments of tax whether made by deduction at source or otherwise.

(3) This Agreement shall apply also to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of this Agreement in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any significant changes which have been made in their respective taxation laws and shall notify each other of any official published material concerning the application of this Agreement, including explanations, regulations, rulings, or judicial decisions.

(4) The United States may impose its personal holding company tax and its accumulated earnings tax notwithstanding any provision of this Agreement. However, a company resident in Malta shall be exempt from the United States personal holding company tax in any taxable year unless 10 per cent or ~~more in~~ value of its stock is owned directly or indirectly,

within the meaning of section 544 of the Internal Revenue Code, by one or more individuals who are residents or citizens of the United States. A company resident in Malta shall be exempt from the United States accumulated earnings tax in any taxable year unless at least 25 per cent of the voting stock of such company is owned by citizens or residents of the United States.

(5) For the purpose of Article 25 (Non-Discrimination), this Agreement shall also apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof.

Article 3

General Definitions

(1) For the purpose of this Agreement, unless the context otherwise requires:

(a) the term "person" includes an individual, a partnership, a company, an estate, a trust, and any other body of persons;

(b) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes;

(c) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

(d) the term "international traffic" means any transport by a ship or aircraft, except where such transport is solely between places in the other Contracting State;

(e) the term "national" means:

(i) in respect of the United States, all individuals possessing the citizenship of the United States of America and all legal persons, partnerships and associations deriving their status as such from the laws in force in the United States;

(ii) in respect of Malta, any citizen of Malta as provided for in Chapter III of the Constitution of Malta and in the Maltese Citizenship Act, 1965, and any legal person, partnership or association deriving its status as such from the law in force in Malta;

(f) the term "competent authority" means:

(i) in the United States: the Secretary of the Treasury or his delegate; and

(ii) in Malta: the Minister responsible for finance or his authorised representative;

(g) (i) the term "United States" means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam or any other United States possession or territory; and

(ii) when used in a geographical sense, such term also includes (a) the territorial sea thereof, to the extent recognized by international law, and (b) the seabed and subsoil of the submarine areas adjacent to the coast thereof, but beyond the territorial sea, over which the United States exercises sovereign rights, in accordance with international law, with respect to the exploration for, and exploitation of, the natural resources of such areas, but only to the extent that the person, property or activity to which this Agreement is being applied is connected with such exploration or exploitation;

(h) (i) the term "Malta" means the Republic of Malta; and

(ii) when used in a geographical sense, the term "Malta" means the Maltese islands, and includes (a) the territorial sea thereof, to the extent recognized by international law, and (b) the seabed and subsoil of the submarine areas

coast thereof, but beyond

sea, over which Malta

exercises sovereign rights, in accordance with international law, with respect to the exploration for, and exploitation of, the natural resources of such areas, but only to the extent that the person, property or activity to which this Agreement is being applied is connected with such exploration or exploitation;

(i) the terms "a Contracting State" and "the other Contracting State" mean the United States or Malta as the context requires.

(2) As regards the application of this Agreement by a Contracting State any term not defined therein shall, unless the context otherwise requires and subject to the provisions of Article 26 (Mutual Agreement Procedure), have the meaning which it has under the laws of that State concerning the taxes to which this Agreement applies.

Article 4

Fiscal Residence

(1) For the purposes of this Agreement, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature, but:

(a) this term does not include any person who is liable to tax in that State in respect only of income from sources in that State; and

(b) in the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax as the income of a resident of that State, either in its hands or in the hands of its partners or beneficiaries.

(2) Where by reason of the provisions of paragraph (1) an individual is a resident of both Contracting States, then his or her status shall be determined as follows:

(a) the individual shall be deemed to be a resident of the State in which he or she has a permanent home available; if such individual has a permanent home available in both States, or in neither State, he or she shall be deemed to be a resident of the State with which his or her personal and economic relations are closer (centre of vital interests);

(b) if the State in which the individual's centre of vital interests cannot be determined, he or she shall be deemed to be a resident of the State in which he or she has an habitual abode;

(c) if the individual has an habitual abode in both States or in neither of them, he or she shall be deemed to be a resident of the State of which he or she is a national;

(d) if the individual is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

(3) Where by reason of the provisions of paragraph (1) a company is a resident of both Contracting States, then if it is created or organized under the laws of a Contracting State or a political subdivision thereof, it shall be treated as a resident of that State.

(4) Where by reason of the provisions of paragraph (1) a person other than an individual or a company is a resident of both Contracting States, the competent authorities of the Contracting States, shall by mutual agreement endeavour to settle the question and to determine the mode of application of the Agreement to such person.

(5) For the purposes of this Agreement, an individual who is a national of a Contracting State shall also be deemed to be a resident of that State if (a) the individual is an employee of that State or an instrumentality thereof in the other Contracting State or in a third State; and (b) the individual is engaged in the performance of governmental functions for the first-mentioned State; and (c) the individual is subjected in the first-mentioned

State to the same obligations in respect of taxes on income as are residents of the first-mentioned State. The spouse and minor children residing with the employee and subject to the requirements of (c) above shall also be deemed to be residents of the first-mentioned State.

(6) Where under any provision of this Agreement income arising in one of the Contracting States is relieved from tax in that Contracting State and, under the law in force in the other Contracting State a person, in respect of the said income, is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State and not by reference to the full amount thereof, then the relief to be allowed under this Agreement in the first-mentioned Contracting State shall apply only to so much of the income as is remitted to or received in the other Contracting State during the year such income accrues or the following year.

Article 5

Permanent Establishment

(1) For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

(2) The term "permanent establishment" shall include especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop; and

(f) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

(3) A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or development of natural resources, or supervisory activities connected therewith, constitutes a permanent establishment but only if such site, project or activity continues for a period or periods aggregating more than 183 days in any twelve month period (including the period of any supervisory activity connected therewith), provided that a permanent establishment shall not exist in any taxable year in which such site, project or activity continues for a period or periods aggregating less than 30 days in that taxable year.

(4) Notwithstanding the preceding prov Article, the term "permanent estab be deemed not to include:

(a) the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;

(e) the maintenance of a fixed place of business solely for the purpose of advertising, for scientific research or for carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;

(f) the maintenance of a fixed place of business solely for any combination of the activities mentioned in subparagraphs (a) to (e) of this paragraph.

(5) Notwithstanding the provisions of paragraphs 1 and 2, where a person - other than an agent of an independent status to whom paragraph 6 applies - is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

(6) An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

(7) The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise) shall not of itself constitute either company a permanent establishment of the other.

Article 6

Income from Immovable Property (Real Property)

(1) Income derived by a resident of a Contracting State from immovable (real) property situated in the other Contracting State may be taxed in that other State.

(2) The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

(3) The provisions of paragraph (1) shall apply to income derived from the direct use, letting,or use in any other form of immovable property.

(4) The provisions of paragraphs (1) and (3) shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

Article 7

Business Profits

(1) The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carried on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

(2) Subject to the provisions of paragraph (3), where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions.

(3) In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, whether incurred in the State in which the permanent establishment is situated or elsewhere.

(4) No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or [illegible] for the enterprise.

(5) For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

(6) The provisions of this Article shall not affect the provisions of the law of a Contracting State regarding the taxation of the business of insurance.

(7) Where profits include items of income which are dealt with separately in other Articles of this Agreement, then the provisions of those Articles shall not be affected by the provisions of this Article.

(8) The term "profits" as used in this Article means income derived from any trade or business whether carried on by an individual, company or any other person, or group of persons, including the rental of tangible personal (movable) property.

Article 8

Shipping and Air Transport

(1) Profits of an enterprise of a Contracting State from the operation in international traffic of ships or aircraft shall be taxable only in that State.

(2) For purposes of this Article, profits from the operation in international traffic of ships or aircraft include profits derived from the rental on a full or bareboat basis of ships or aircraft if operated in international traffic by the lessee or if such rental profits are incidental to other profits described in paragraph (1).

(3) Profits of an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers, barges and related equipment for the transport of containers) used for the transport in international traffic of goods or merchandise shall be taxable only in that State.

(4) The provisions of paragraphs (1) and (3) shall also apply to profits from the participation in a pool, a joint business or an international operating agency.

(5) Notwithstanding the other provisions of this Article, profits from the operation of a ship in international traffic and gains from the sale, exchange or other alienation of such a ship, derived by a corporation resident in Malta which has more than 25 per cent of its voting stock owned, directly or indirectly, by persons not resident in Malta, may be taxed by the United States unless the corporation proves that the profits derived from the operation of such ship are subject to Malta tax without regard to any relief therefrom as provided for in section 86 of the Merchant Shipping Act, 1973, or similar provision.

Article 9

Associated Enterprises

(1) Where

(a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

(b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

(2) Where a Contracting State includes in the profits of an enterprise of that State, and taxes accordingly, profits on which an enterprise of the other Contracting State has been charged to tax in that other State, and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Agreement and the competent authorities of the Contracting States shall if

[illegible] each other.

(3) The provisions of paragraph (1) shall not limit any provisions of the law of either Contracting State which permit the distribution, apportionment or allocation of income, deductions, credits, or allowances between persons owned or controlled directly or indirectly by the same interests when necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such persons.

Article 10

Dividends

(1) Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

(2) However, such dividends may also be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the laws of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

(a) in the case of United States:

(i) 5 per cent of the gross amount of the dividends if the beneficial owner is a company (other than a partnership) which owns, directly or indirectly, at least 10 per cent of the voting stock of the company paying the dividends;

(ii) 15 per cent of the gross amount of the dividends in all other cases;

(b) in the case of Malta:

that chargeable on the company paying the dividends in the year during which distribution is made.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

(3) The term "dividends" as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to

the same taxation treatment as income from shares by the laws of the State of which the company making the distribution is a resident.

(4) The provisions of paragraphs (1) and (2) shall not apply if the recipient of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State, of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), asthe case may be, shall apply.

(5) Where a company is a resident of a Contracting State, the other Contracting State may not impose any tax on the dividends paid by the company, except insofar as

(a) such dividends are paid to a resident of that other State;

(b) the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, or

(c) such dividends are paid out of profits attributable to one or more permanent establishments which such company had in that other State, provided that such profits constituted at least 50 per cent of such company's gross income from all sources.

Where subparagraph (c) applies and subparagraphs (a) and (b) do not apply, any such tax shall be subject to the limitations of paragraph (2).

Article 11

Interest

(1) Interest arising in a Contracting State which is derived and beneficially owned by a resident of the other Contracting State may be taxed in that other State.

(2) However, such interest may be taxed in the Contracting State in which it arises and according to the law of that State, but the tax so charged shall not exceed 12½ per cent of the gross amount of such interest.

(3) Notwithstanding paragraphs (1) and (2), interest beneficially derived by one of the Contracting States, or by an instrumentality of that Contracting State not subject to tax by that Contracting State on its income shall be exempt from tax by the other Contracting State.

(4) The term "interest" as used in this Agreement means income from debt-claims of every kind, whether or not secured by mortgage, and whether or not carrying a right to participate in the debtor's profits, and in particular, income from Government securities and income from bonds or debentures, including premiums or prizes attaching to such securities, bonds or debentures. Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

(5) The provisions of paragraph (2) shall not apply if the beneficial owner of the interest, being a

ing State, carries on

Contracting State in which

the interest arises, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt-claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

(6) Interest shall be deemed to arise in a Contracting State when the payer is that State itself, a political subdivision, a local authority or a resident of that State. Where, however, the person paying the interest, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment or fixed base, then such interest shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

(7) Where, by reasons of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest, having regard to the debt-claim for which it is paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Agreement.

(8) A Contracting State may not impose any tax on interest paid by a resident of the other Contracting State, except insofar as

(a) such interest arises in, or is paid to a resident of, the first-mentioned State, or

(b) the debt claim in respect of which the interest is paid is effectively connected with a permanent establishment or a fixed base situated in the first-mentioned State.

Article 12

Royalties

(1) Cultural royalties derived and beneficially owned by a resident of a Contracting State shall be taxable only in that State.

(2) Industrial royalties arising in a Contracting State which are derived and beneficially owned by a resident of the other Contracting State:

(a) may be taxed by both Contracting States, but

(b) shall not be taxed in the Contracting State in which they arise at a rate in excess of 12½ per cent of the gross amount of such royalties.

(3) For the purposes of this Article:

(a) cultural royalties are payments of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works;

(b) industrial royalties are payments of any kind made as consideration for:

(i) the use of, or the right to use cinematographic films or tapes for television or broadcasting, patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights; and

(ii) the supply of scientific, technical, industrial or commercial knowledge or information (know-how) held by the person supplying such know-how including the supply of any assistance of an ancillary

and subsidiary nature supplied as a means of enabling the application or enjoyment of such know-how or any other property or right to which this article applies; and

(c) cultural royalties and industrial royalties include gains derived from the sale, exchange, or other alienation of any such property or rights to the extent that the amounts realized on such sale, exchange, or other alienation for consideration are contingent on the productivity, use, or alienation of such property or rights.

(4) The provisions of paragraphs (1) and (2)(b) shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State, in which the royalties arise through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 14 (Independent Personal Services), as the case may be, shall apply.

(5) Royalties shall be deemed to arise in a Contracting State when the payer is that State itself, a political subdivision, a local authority or a resident of that State. However, where the property or rights for which the royalties are paid are used within the United States or Malta, as the case may be, the royalties shall be deemed to arise in the State in which the property or rights are used.

(6) Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the person deriving the royalties in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Agreement.

Article 13

Capital Gains

(1) Gains derived by a resident of a Contracting State from the alienation of immovable property referred to in Article 6 (Income From Immovable Property (Real Property)) and situated in the other Contracting State as well as gains from the alienation of shares of a company the assets of which consist, directly or indirectly, principally of such immovable property may be taxed in that other State.

(2) Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base, may be taxed in that other State.

(3) Gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft or containers operated by such enterprise in international traffic shall be taxable only in that State, and gains described in Article 12 (Royalties) shall be taxable only in accordance with the provisions of Article 12.

(4) Gains from the alienation of any property other than that referred to in paragraphs (1), (2), and (3), shall be taxable only in the Contracting State of which the alienator is a resident.

Article 14

Independent Personal Services

(1) Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall be taxable only in that State unless such services are performed in the other Contracting State and

(a) the individual is present in that other State for a period or periods aggregating more than 90 days in the taxable year concerned, or

(b) the individual has a fixed base regularly available to him in that other State for the purpose of performing his activities, but only so much of the income as is attributable to that fixed base may be taxed in such other State, or

(c) the remuneration for his services in the other Contracting State is derived from residents of that State and exceeds ten thousand United States dollars or the equivalent during the taxable year.

(2) The term "personal services" referred to in this Article includes, especially, independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 15

Dependent Personal Services

(1) Subject to the provisions of Articles 17 (Directors' Fees), 19 (Pensions and Annuities) and 20 (Government Service), salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

(2) Notwithstanding the provisions of paragraph (1), remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the taxable year concerned, and

(b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and

(c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

(3) Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment as a member of the regular complement of a ship or aircraft operated by an enterprise of a Contracting State in international traffic may be taxed in that Contracting State.

Article 16

Investment or Holding Companies

If 25 per cent or more of the capital of a company which is a resident of a Contracting State is owned directly or indirectly by individuals who are not residents of that State, and if by reason of special measures the tax imposed by that State on that company with respect to dividends, interest or royalties arising in the other Contracting State is substantially less than the tax generally imposed by the first-mentioned State on company business profits, then, notwithstanding the provisions of Articles 10 (Dividends), 11 (Interest), or 12 (Royalties), that other State may tax such dividends, interest or royalties. For the purposes of this Article, the source of dividends, interest or royalties shall be determined in accordance with subparagraphs (a), (b) or (c) of paragraph 3 of Article 24 (Relief from Double Taxation).

Article 17

Directors' Fees

Notwithstanding Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services), directors' fees derived by a resident of one of the Contracting States in his capacity as a member of the board of directors of a company of the other Contracting State (but not including fixed or contingent payments derived in his capacity as an officer or employee) may, to the extent such fees are in excess of a reasonable fixed amount payable to all directors of the company for attendance at a directors' meeting in such other Contracting State, be taxable in such other Contracting State, whether or not such director is physically present in such other Contracting State in connection with his duties as a director.

Article 18

Artistes and Athletes

(1) Notwithstanding the provisions of Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services), income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as an athlete, from his or her personal activities as such exercised in the other Contracting State, may be taxed in that other State if:-

(a) the artiste or athlete is present in that other Contracting State for a period or periods aggregating 90 days or more during the taxable year, or

(b) such income exceeds 500 United States dollars or the equivalent for each day of performance, including rehearsal, or five thousand United States dollars or the equivalent, in the taxable year.

(2) Where income in respect of activities exercised by an entertainer or an athlete in his or her capacity as such accrues not to that entertainer or athlete but to another person, that income may, notwithstandi the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services), and 15 (Dependen Personal Services), be taxed in the Contracting Stat in which the activities of the entertainer or athlete are exercised. For the purposes of the preceding sentence, income of an entertainer or athlete shall be deemed not to accrue to another person if it is established that neither the entertainer or athlete, nor persons related thereto, participate directly or indirectly in the

profits of such other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions or other distributions.

Article 19

Pensions and Annuities

(1) Subject to the provisions of paragraph 2 of Article 20 (Government Service), pensions and other similar remuneration beneficially derived by a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

(2) Annuities beneficially derived by a resident of a Contracting State shall be taxable only in that State. The term "annuities" as used in this paragraph means a stated sum paid periodically at stated times during life or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

Article 20

Government Service

(1) (a) Remuneration, other than a pension, paid by a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

(b) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the individual is a resident of that State who:

(i) is a national of that State; or

(ii) did not become a resident of that State solely for the purpose of rendering the services;

provided that the provisions of clause (ii) shall not apply to the spouse or dependent children of an individual who is receiving remuneration to which the provisions of subparagraph (a) apply and who does not come within the terms of clause (i) or (ii).

(2) (a) Any pension paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority shall be taxable only in that State.

(b) However, such pension shall be taxable only in the other Contracting State if the individual is a resident of, and a national of that State.

(3) The provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 18 (Artistes and Athletes), and 19 (Pensions and Annuities), shall apply to remuneration and pensions in respect of services rendered in connection with a business carried on by a Contracting State or a political subdivision or a local authority thereof.

Article 21

Teachers

(1) Remuneration which a professor or teacher who is, or immediately before was, a resident of a Contracting State and who visits the other Contracting State for a period not exceeding two years for the purpose of carrying out advanced study or research or for teaching at a University, college, school or other educational institution receives for such work shall not be taxed in that other State, provided that such remuneration is paid to him from sources outside that other State.

(2) This article shall not apply to income from research if such research is undertaken not in the public interest but primarily for the private benefit of a specific person or persons.

Article 22

Students And Trainees

(1) Payments which a student, apprentice or business trainee who is or was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned State for the purpose of his or her full-time education or training receives for the purpose of his or her maintenance, education or training shall not be taxed in that State provided that such payments arise from sources outside that State.

(2) An individual to whom paragraph (1) applies may elect to be treated for tax purposes as a resident of the first-mentioned State. The election shall apply to all periods during the taxable year of the election and subsequent taxable years during which the individual qualifies under paragraph (1), and may not be revoked except with the consent of the competent authority of that State.

Article 23

Other Income

(1) Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Agreement shall be taxable only in that State.

(2) The provisions of paragraph (1) shall not apply to income other than income from immovable property as defined in paragraph (2) of Article 6 (Income From Immovable Property (Real Property)), if the person deriving the income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits), Article 14 (Independent Personal Services), or Article 18 (Artistes and Athletes) as the case may be, shall apply.

Article 24

Relief From Double Taxation

(1) In the case of the United States, double taxation shall be avoided as follows: In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income or capital the appropriate amount of tax paid to Malta; and, in the case of a United States company owning at least 10 per cent of the voting stock of a company which is a resident of Malta from which it receives dividends in any taxable year, the United States shall allow as a credit against the United States tax on income the appropriate amount of tax paid to Malta by that company with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid to Malta, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources outside of the United States) provided by United States law for the taxable year. For purposes of applying the United States credit in relation to tax paid to Malta the taxes referred to in paragraphs (2)(b) and (3) of Article 2 (Taxes Covered) shall be considered to be income taxes.

(2) In the case of Malta, double taxation shall be avoided as follows:

Subject to the provisions of the law of Malta regarding the allowance of a credit against Malta tax in respect of foreign tax, where, in accordance with the

provisions of this Agreement, there is included in a Malta assessment income from sources within United States, the United States tax on such income shall be allowed as a credit against the Malta tax payable thereon. Where a company which is a resident of the United States pays a dividend to a company resident in Malta owning at least 10 per cent of the voting stock in the United States company, the credit shall, in addition, take into account the United States tax payable by the United States company in respect of the profits out of which the divident is paid.

(3) For the purposes of the preceding paragraphs of this Article, the source of income or profits shall be determined in accordance with the following rules:

(a) Dividends, as defined in paragraph (3) of Article 10 (Dividends), shall be deemed to arise in a Contracting State if paid by a company which is a resident of that State or if paragraph (5)(c) of Article 10 applies.

(b) Interest, as defined in paragraph (4) of Article 11 (Interest), shall be deemed to arise in the State specified in paragraph (6) of Article 11.

(c) Royalties, as defined in paragraph (3) of Article 12 (Royalties), shall be deemed to arise in the State specified in paragraph (5) of Article 12.

(d) Except for income or profits referred to in sub-paragraphs (a), (b) or (c), and except for income or profits taxed by the United States solely by reason of citizenship in accordance with paragraph (3) of Article 1 (Personal Scope): income or profits derived by a resident of a Contracting State which may be taxed in the other Contracting State in accordance with this Agreement shall be deemed to arise in that other Contracting State.

Article 25

Non-Discrimination

(1) Nationals of a Contracting State shall not be subjected in the other State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. For purposes of the preceding sentence, nationals who are subject to tax by a Contracting State on worldwide income are not in the same circumstances as nationals who are not so subject. This provision shall, notwithstanding the provisions of Article 1 (Personal Scope), also apply to persons who are not residents of one or both of the Contracting States.

(2) The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

(3) Except where the provisions of paragraph (1) of Article 9 (Associated Enterprises), paragraph (5) of Article 11 (Interest), or paragraph (4) of Article 12 (Royalties) apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other

Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same condition as if they had been paid to a resident of the first-mentioned State.

Similarly, any debts of an enterprise of a Contracting State, to a resident of the other Contracting State, shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

(4) Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

(5) The provisions of this Article shall apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof.

Article 26

Mutual Agreement Procedure

(1) Where a person considers that the actions of one or both of the Contracting States result or will result for him or her in taxation not in accordance with the provisions of this Agreement, he or she may, irrespective of the remedies provided by the domestic law of those States, present his or her case to the competent authority of the Contracting State of which he or she is a resident or national.

(2) The competent authority shall endeavour if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Agreement. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.

(3) The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Agreement. In particular the competent authorities of the Contracting States may agree:

(a) to the same attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State;

(b) to the same allocation of income, deductions, credits, or allowances between persons, including a uniform position on the appli- cation of the requirements of paragraph (2

of Article 25 (Non-discrimination);

(c) to the same characterization of particular items of income;

(d) to the same application of source rules with respect to particular items of income;

(e) to a common meaning of a term; and

(f) to increases in any dollar amounts referred to in the Agreement to reflect monetary or economic developments.

They may also consult together for the elimination of double taxation in cases not provided for in the Agreement.

(4) The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

(5) The competent authorities of the Contracting States may prescribe regulations to carry out the purposes of this Agreement.

Article 27

Exchange of Information

(1) The competent authorities of the Contracting States shall exchange such information as is necessary for carrying out the provisions of this Agreement or of the domestic laws of the Contracting States concerning taxes covered by the Agreement insofar as the taxation thereunder is not contrary to the Agreement. The exchange of information is not restricted by Article 1 (Personal Scope). Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the Agreement. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

(2) If specially requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of authenticated copies of unedited original documents (including books, paper, statements, records, accounts, or writings), to the same extent such documents can be obtained under the laws and administrative practices of such other State with respect to its own taxes.

(3) In no case shall the provisions of paragraph (1) be construed so as to impose on a Contracting State the obligation:

(a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

(b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (ordre public).

Article 28

Diplomatic Agents and Consular Officers

Nothing in this Agreement shall affect the fiscal privileges of diplomatic agents or consular officers under the general rules of international law or under the provisions of special agreements.

Article 29

Entry Into Force

(1) This Agreement shall be subject to ratification in accordance with the applicable procedures of each Contracting State and instruments of ratification shall be exchanged at ____________________ as soon as possible.

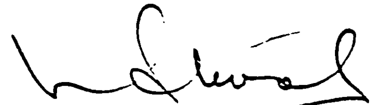
(2) The Agreement shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect in respect of income or profits arising on or after the first day of January of the year in which the Agreement enters into force.

Article 30

Termination

This Agreement shall remain in force until terminated by one of the Contracting States. Either Contracting State may terminate the Agreement at any time after 3 years from the date on which this Agreement enters into force provided that at least 6 months' prior notice of termination has been given through diplomatic channels. In such event, the Agreement shall cease to have force and effect as respects income or profits arising on or after January 1 next following the expiration of the 6-month period.

DONE at VALLETTA in duplicate, in the English language, this 21st day of March 1980.



FOR THE GOVERNMENT OF THE UNITED STATES OF AMERICA:

FOR THE GOVERNMENT OF THE REPUBLIC OF MALTA:

EXCHANGE OF LETTERS BETWEEN THE UNITED STATES AND MALTA RELATING TO UNDERSTANDING IN REGARD TO CERTAIN PROVISIONS OF THE INCOME TAX AGREEMENT

Valletta, Malta

March 21, 1980

Sir:

I have the honor of commenting on the Agreement between the United States of America and Malta with respect to taxes on income, signed today. The following understandings were reached between the two Governments.

(1) In the process of negotiating this Agreement, the delegation from Malta emphasized the necessity of including in the Agreement additional provisions which will create incentives to promote the flow of investment to Malta.

The United States delegation is not able to accept such provisions at this time. However, I wish to assure you that my Government realizes the importance your Government attaches to the increase of investments in Malta. Should circumstances change, including any changes in the manner in which the United States imposes income tax upon the income of United States investments in Malta, our Government would be prepared to reopen the discussions in order to reflect in this Agreement

minimize the conflicts

between the United States tax system and the incentives proposed by the Government of Malta to foreign investors and which are consistent with the income tax policies of the United States, including treaty policies, with respect to other developing countries.

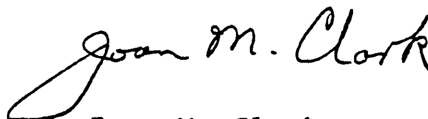
(2) In the case of profits from the operation of a ship in international waters to which paragraph (5) of Article 8 (Shipping and Air Transport) of the Agreement applies, the said profits shall be deemed to constitute profits to which the provisions of Article 7 (Business Profits) shall apply.

(3) In the case of interest referred to in paragraph (2) of Article 11 of the Agreement and in the case of Royalties referred to in paragraph (2) of Article 12, Malta will bring to charge the income in question at the normal Malta rates as part of the total income of the recipient which is liable to Malta tax for the year in question. In computing the amount of interest and royalties, respectively subject to tax as above, Malta will allow as a deduction any expenses proved to have been incurred in the production of the said income. In applying the limitations set out in the two paragraphs, Malta will restrict its tax on the income so computed (such tax to be determined in an amount arrived at by multiplying the total tax chargeable by a

fraction having the net interest or royalty, respectively, as its numerator and the total income as its denominator), to a maximum of 12 1/2% of the relative gross interest or royalty, as the case may be.

If this is in accordance with your understanding, I would appreciate an acknowledgement from you to that effect.

Accept, Sir, the renewed assurances of my highest consideration.



Joan M. Clark
American Ambassador

Mr. Robert J. Stivala
Secretary
Ministry of Finance, Customs, and
People's Financial Investments
Valletta

Valletta, Malta,

21 March 1980.

Excellency:

I have the honour to refer to your letter of today's date, which reads as follows:

"Sir:

I have the honor of commenting on the Agreement between the United States of America and Malta with respect to taxes on income, signed today. The following understandings were reached between the two Governments.

(1) In the process of negotiating this Agreement, the delegation from Malta emphasized the necessity of including in the Agreement additional provisions which will create incentives to promote the flow of investment to Malta.

The United States delegation is not able to accept such provisions at this time. However, I wish to assure you that my Government realizes the importance your Government attaches to the increase of investments in Malta. Should circumstances change, including any changes in the manner in which the United States imposes income tax upon the income of United States investments in Malta, our

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discussions in order to reflect in this Agreement provisions which would minimize the conflicts between the United States tax system and the incentives proposed by the Government of Malta to foreign investors and which are consistent with the income tax policies of the United States, including treaty policies, with respect to other developing countries.

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(such tax to be determined in an amount arrived at by multiplying the total tax chargeable by a fraction having the net interest or royalty, respectively, as its numerator and the total income as its denominator), to a maximum of 12 1/2% of the relative gross interest or royalty, as the case may be.

If this is in accordance with your understanding, I would appreciate an acknowledgement from you to that effect.

Accept, Sir, the renewed assurances of my highest consideration.

Joan M. Clark
American Ambassador"

I have the honour to confirm that the contents of your letter are in accordance with my Government's understanding on the matters in question.

R. Stivala,

Secretary,

Ministry of Finance,

Customs and People's

Financial Investments.

artment of the TREASURY NEWS
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IMMEDIATE RELEASE
April 18, 1980

CONTACT: Everard Munsey
202/566-8191

TREASURY ISSUES REGULATIONS ON IRAN

The Treasury Department today issued regulations implementing President Carter's decision to ban imports from Iran and to prohibit travel and payments to Iran, except by journalists and other employees of news organizations and remittances to close relatives.

The effect of the prohibitions on travel and payments is to prevent Americans and permanent residents of the United States -- other than those who are also citizens of Iran -- from going to Iran and make it necessary for Americans now in Iran to leave.

The new ban on payments to Iran extends to any payment, transfer of credit or other transfer of funds or property to any person in Iran. Except for payments to close relatives, private Iranian deposits in the U.S. may not be used to make payments to anyone in Iran, but they remain otherwise unblocked.

The regulations, which amend the existing Iranian Asset Control Regulations, are attached. They will be published in the Federal Register of April 21, 1980.

# # #

M-442

IN ADVANCE OF PRINTED COPY

DEPARTMENT OF TREASURY

Office of Foreign Assets Control

[31 CFR Part 535]

Iranian Assets Control Regulations; Additional Prohibitions

AGENCY: Office of Foreign Assets Control, Department of the Treasury

ACTION: Final Rule

SUMMARY: The Office of Foreign Assets Control is amending the Iranian Assets Control Regulations. The purpose of the amendment is to impose additional prohibitions on dealings with Iran. The need for the amendment is to implement the provisions of Executive Order No. 12211, signed by the President on April 17, 1980. The effect of the amendment is that imports of goods from Iran or of Iranian origin merchandise are prohibited; that payments or transfers of funds or other property to any person in Iran are prohibited; and that payments and transactions in support of travel to and maintenance within Iran of U.S. citizens and U.S. permanent resident aliens are prohibited.

EFFECTIVE DATE: April 17, 1980

FOR FURTHER INFORMATION CONTACT: Dennis M. O'Connell, Chief Counsel, Office of Foreign Assets Control, Department of the Treasury, Washington, D.C. 20220, Tel. 202/376-0236.

SUPPLEMENTARY INFORMATION: Since the regulations involve a foreign affairs function, the provisions of the Administrative Procedure Act, 5 U.S.C. 553, requiring notice of proposed rule making, opportunity for public participation and delay in effective date are inapplicable.

The prohibition set forth in new §535.209 on payments and transactions in support of travel to and maintenance within Iran by U.S. citizens and permanent resident aliens does not apply to U. S. citizens or permanent resident aliens who are also citizens of Iran.

Paragraph (a) of new §535.562 authorizes imports of news material by newsgathering agencies, notwithstanding the prohibitions on imports in §535.204. Paragraph (b) of §535.562 authorizes transactions in connection with newsgathering activities of journalists and news correspondents, notwithstand the travel and maintenance payment restrictions of §535.209 and the import restrictions of §535.204 and the prohibitions in §535.201 on payments or other transfers of property in which Iran or an Iranian entity has an interest.

In addition, new §535.563 authorizes remittances to any close relative who is a citizen of Iran and who is a resident of and within Iran notwithstanding the new prohibition on the payment or transfer of any funds or other property to any person in Iran. The prohibitions do not affect remittances from Iran.

The new prohibitions on payments or other financial transfers in §535.206(a)(4) bars any withdrawal from, or debit to, an account within the United States by a person in Iran for purposes of any transfer to any person in Iran. However, such an account is not a blocked account and may be used for payments or transfers within the United States.

31 CFR, Part 535 is amended as follows:

1. §535.204 is added as follows:

§535.204 Imports from Iran or Iranian merchandise.

Except as specifically authorized by the Secretary of the Treasury (or by any person, agency, or instrumentality designated by him) by means of regulations, rulings, instructi licenses, or otherwise, no merchandise, other goods or services of Iranian origin may be imported into the United States if such merchandise or goods are or have been located in or transported from or through Iran after the effective date of this section.

2. §535.206 is amended by the addition of paragraph (a)(4) as follows:

§535.206 Financial transactions.

* * * * *

(4) Make any payment, transfer of credit, or other transfer of funds or other property or interests therein to any person in Iran.

* * * * *

3. §535.208 is amended by the addition of paragraph (c) as follows:

§535.208 Evasions; effective date.

* * * * *

(c) With respect to any amendments of the foregoing sections or any other amendments to this part the term "effective date" shall mean the date of filing with the Federal Register.

4. §535.209 is added as follows:

§535.209 Transactions incident to travel and maintenance of U.S. nationals in Iran prohibited.

(a) The following actions by persons subject to the jurisdiction of the United States are prohibited:

(1) Any direct or indirect payment or transaction (including any transfer, other dealing in, or use of property) either to, by, on behalf of,or other otherwise involving, any foreign country or any national thereof, which is incident to travel to, or travel or maintenance within Iran of any individual who is a U.S. citizen or U.S. permanent resident alien.

(b) The prohibitions of paragraph (a) of this section do not apply to transactions incident to travel or maintenance within Iran of individuals who are citizens of Iran.

(c) The effective date of this prohibition, as it relates to payments by or for the benefit of U.S. citizens or U.S. permanent resident aliens in Iran is April 24, 1980.

5. §535.562 is added as follows:

§535.562 News material.

(a) Imports by newsgathering agencies. The purchase and importation of Iranian origin newspapers, magazines, photographs, films, tapes, and other news material or copies therof by newsgathering agencies in the United States are authorized, without restriction as to method of payment, provided such materials are intended for use in news publication or news broadcast dissemination.

(b) Newsgathering activities in Iran by journalists and news correspondents. The following transactions by a journalist or other person who is regularly employed by a news gathering or transmitting organization who travels to Iran or is within Iran for the purposes of gathering or transmitting news, filming news or making documentary films, similar activities are authorized:

(1) payment of expenses for travel to, and maintenance within, Iran for the purposes of gatherin and transmitting news to the United States; and

(2) the acquisition in Iran for transmission to and importation into the United States of newspape magazines, photographs, films, tapes, and other news material or copies thereof, necessary for the journalistic assignments.

(3) Within 5 days after engaging in the initial transaction with respect to a trip to or stay within Iran covered by this paragraph, the person engaging in the transaction, or the organization by which such person is employed, shall notify the Office of Foreign Assets Control. The notification shall include the name of the person upon whose behalf the general license is being used. Within 5 days after his departure from Iran, any person utilizing the general license shall send a second notification to the Office of Foreign Assets Control that he has departed Iran.

6. §535.563 is added as follows:

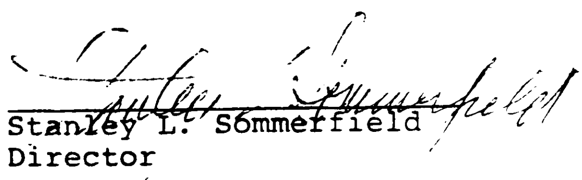
§535.563 Family remittances to Iran.

(a) Remittances to any close relative of the remitter or of the remitter's spouse, who is a citizen of Iran and who is a resident of and within Iran, are authorized provided they do not involve any debit to a blocked account and are for the support of the payee and members of his household.

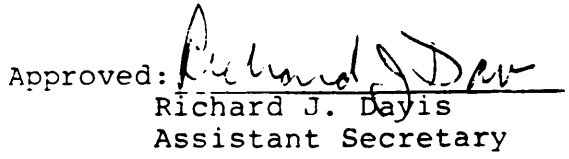
(b) The term "close relative" used with respect to any person means spouse, child, grandchild, parent, grandparent, uncle, aunt, brother, sister, nephew, niece, or spouse, widow, widower of any of the foregoing.

(c) The term "member of a household" used with respect to any person means a close relative sharing a common dwelling with such person.

Dated: 17 APR 1980



Stanley L. Sommerfield
Director



Approved:
Richard J. Davis
Assistant Secretary

[Authority: Sec. 201-207, 91 Stat. 1626, 50 U.S.C. 1701-1706; E.O. No. 12170, 44 FR 65729, E.O. No. 12205, 45 FR 24099; E.O. No. , 45 FR .]

Filed: April 18, 1980

Publication date: April 21, 1980

partment of the TREASURY
NEWS
INGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE April 21, 1980

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,506 million of 13-week bills and for $3,500 million of 26-week bills, both to be issued on April 24, 1980, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 24, 1980			:	26-week bills maturing October 23, 1980		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	96.792	12.691%	13.29%	:	94.039	11.791%	12.71%
Low	96.769	12.782%	13.39%	:	93.963	11.941%	12.89%
Average	96.782	12.731%	13.34%	:	93.988	11.892%	12.83%

Tenders at the low price for the 13-week bills were allotted 27%.
Tenders at the low price for the 26-week bills were allotted 40%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 44,230	$ 33,955	:	$ 26,110	$ 26,110
New York	6,744,040	2,758,265	:	4,769,945	2,722,825
Philadelphia	34,645	32,205	:	22,935	22,935
Cleveland	120,660	41,335	:	39,140	36,640
Richmond	56,785	44,685	:	66,650	66,650
Atlanta	69,010	59,525	:	53,105	47,655
Chicago	409,445	64,715	:	343,780	109,380
St. Louis	42,695	31,695	:	25,130	16,130
Minneapolis	24,515	9,515	:	22,720	22,720
Kansas City	49,170	40,020	:	34,750	34,750
Dallas	22,975	22,975	:	15,685	15,685
San Francisco	591,095	233,985	:	430,475	247,375
Treasury	132,735	132,735	:	131,270	131,270
TOTALS	$8,342,000	$3,505,610	:	$5,981,695	$3,500,125
Type					
Competitive	$6,070,085	$1,233,695	:	$3,944,500	$1,462,930
Noncompetitive	865,885	865,885	:	690,795	690,795
Subtotal, Public	$6,935,970	$2,099,580	:	$4,635,295	$2,153,725
Federal Reserve	868,880	868,880		868,000	868,000
Foreign Official Institutions	537,150	537,150	:	478,400	478,400
TOTALS	$8,342,000	$3,505,610	:	$5,981,695	$3,500,125

partment of the TREASURY

NEWS

HINGTON, D.C. 20220 TELEPHONE 566-2041

IMMEDIATE RELEASE
April 22, 1980

CONTACT: Charles Arnold
202/566-8041

TASK FORCE SEEKS PUBLIC COMMENTS ON THRIFT INSTITUTIONS

The Interagency Task Force on Thrift Institutions is seeking public comment by May 12 on several matters related to thrift institutions.

The Depository Institutions Deregulation and Monetary Control Act of 1980 requires the Task Force to conduct a study and make recommendations to Congress by June 30 regarding:

* "the options available to provide balance to the asset-liability management problems inherent in the thrift portfolio structure;

* "the options available to increase the ability of thrift institutions to pay market rates of interest in periods of rapid inflation and high interest rates, and

* "the options available through the Federal Home Loan Bank system and other Federal agencies to assist thrifts in times of economic difficulties."

Written comments by business and labor, consumer and public interest groups, state regulators of depository institutions and others should be submitted to John J. Mingo, Deputy Assistant Secretary of the Treasury for Capital Markets Policy, Room 3025, Treasury Department, 15th Street and Pennsylvania, N.W., Washington, D.C. 20220. All comments will become part of the public record.

The Task Force is chaired by Deputy Secretary of the Treasury Robert Carswell and Stuart Eizenstat, Assistant to the President for Domestic Affairs and Policy. Also represented on the Task Force are the Office of Management and Budget, the Council of Economic Advisers, the Department of Housing and Urban Development, the Federal Reserve Board, the Home Loan Bank Board, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the National Credit Union Administration Board.

# # #

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NEWS
HINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE ON DELIVERY
Expected at 2:00 P.M.
April 22, 1980

STATEMENT OF CHARLES SCHOTTA
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR COMMODITIES AND NATURAL RESOURCES
BEFORE THE
SUBCOMMITTEE ON
INTERNATIONAL ECONOMIC POLICY
HOUSE COMMITTEE ON FOREIGN AFFAIRS

IMPLEMENTING LEGISLATION FOR U.S. MEMBERSHIP
IN THE INTERNATIONAL NATURAL RUBBER AGREEMENT

Introduction

Mr. Chairman:

I appreciate this opportunity to appear before you today to testify in favor of an Administration request for authorizing legislation for the new International Natural Rubber Agreement. In addition to seeking the advice and consent of the Senate, we are seeking this legislation to authorize the appropriation necessary to support U.S. membership in the Agreement.

The Treasury Department strongly endorses this authorizing legislation and has recommended approval of the required appropriation at an early date. Ratification of the Agreement and passage of authorizing legislation will demonstrate the firm commitment of the United States Government to the agreement itself, and to our overall international commodity policy. That policy is designed to promote key economic interests of the U.S., most notably, greater price stability to enhance our fight against

inflation. President Carter has made prominent reference to international commodity trade and the potential role of international commodity agreements in contributing to the battle against inflation in the United States:

> "When prices of raw materials and food fluctuate upward, the effects tend to spread throughout the economy, raising prices and wages generally ... Reducing fluctuations in commodity prices, therefore, helps to reduce inflation."

This objective was reiterated in the Administration's January testimony before the Senate Budget Committee when Secretary Miller and others stated that, "properly constructed commodity agreements can provide benefits to both producers and consumers by reducing inflationary pressures, promoting greater stability and increasing incentives for primary commodity production." They went on to indicate that the Natural Rubber Agreement is exemplary of an international commodity arrangement which balances producer and consumer interests to their mutual benefit.

Treasury Assistant Secretary Bergsten reaffirmed these points on March 4, 1980 before the House Appropriations Subcommittee on Treasury, Postal Service and General Government. At that time, the Administration recommended approval of an $88 million appropriation to support U.S. membership in the Agreement. Of that amount, our roughly $5 million share of initial contributions of $33 million from all countries to the Agreement is likely to be our only outlay in fiscal year 1981.

Under Secretary Cooper has described to you the operation of the Agreement. I would like to focus my initial remarks on this Administration's commitment to our overall international commodity policy, and on how the Natural Rubber Agreement integrates as an important element of that policy.

Administration Commodity Policy

One of the international economic policy decisions taken in the early part of this Administration was to reorient U.S. policy from leaving commodity trade to the instability which is characteristic of commodity markets, to seeking deliberate measures to reduce fluctuations in prices and promote stability of supply. This shift in policy reflects the Administration's continuing concern about the adverse effects of volatile commodity prices on inflation in the United States, on the economies of all exporting and importing countries, on individual producers and consumers, and on the orderly expansion of raw material supplies. The price stabilization objective of our new international commodity policy, I might add, is entirely distinct from our strategic stockpiling objectives, which are to hold designated amounts of materials to be released only when needed by the U.S. economy in times of national emergency.

Prices of primary commodities are quite volatile, and the U.S. economy experiences real costs from this instability. For example, excessive rises in commodity prices, even when they are temporary, induce economy-wide price increases which often extend beyond the direct impact of the commodity prices themselves.

This is because producers of manufactured goods and food processors frequently justify additional increases in their prices on the basis of cost increases stemming from rising prices for their raw materials. However, these increases are not likely to recede when raw material prices subsequently decrease. The effect is a ratcheting up of the general consumer price index, which in turn provides justification for higher wage increases. As inflation spreads, for this as well as other reasons, inflationary expectations then generate additional demand for business inventories and create fears of impending shortages, provoking protective purchases and forcing raw material prices up even further in a spiral which, as we saw particularly in 1973-1974, can be devastating.

Paradoxically, excessive price declines for commodities can also create upward pressure on the price level over the long run. When commodity price declines are precipitate and extended over a period of time, they can give rise to a lagged decrease in investment in new productive capacity at both the primary and processing stages. With inadequate capacity, supply becomes insufficient to meet the normal growth of demand in future years, and as a result, prices ultimately are pressured to increase.

These two occurrences are peculiar to some of the commodity markets because prices in these markets fluctuate much more sharply than do prices of other commodities or industrial products.

It is often postulated that the market provides the optimal degree of price stability for commodity trade. Unfortunately,

this is not always the case as evidenced by price volatility caused by the pattern of successive gluts and shortages. A buffer stocking mechanism moderates supply available to the market and reduces price fluctuations, thus rendering direct benefits to all buyers and sellers. In addition, the indirect benefits of price stabilization -- notably the reduction of overall inflation rates and the reduced risk of widespread economic collapse -- extend well beyond the universe of participants in the commodity markets themselves. Thus, price stability can be considered a public good, and an appropriate target for governmental action.

Economies of export countries also suffer significantly as a result of gyrating commodity prices. Many of these countries are small, developing countries, whose exports constitute a large portion of their G.N.P. They rely heavily on commodity exports for employment of their labor force, and for their foreign exchange earnings, which are used largely to buy agricultural and industrial products from suppliers such as the U.S. In 1979, for example, we sold $5.2 billion of goods to the four largest natural rubber producing countries. This amount represents more than a 30 percent increase over 1978. Extreme volatility in commodity prices weakens the purchasing power of these exporters, and in turn, the ability of the United States to maximize our export potential to these countries.

It was against this background that the Administration decided to initiate a new policy to help contain inflationary pressures emerging from commodity markets, reduce our vulnerability to unreliable and uneconomic sources of supply, and enhance economic stability in producing countries. This U.S. policy consists of the following elements:

-- negotiation of international commodity agreements, where feasible, between producers and consumers to reduce excessive price volatility;

-- emphasis on buffer stocking as the preferred price stabilizing mechanism;

-- joint financial responsibility among producers and consumers for financing such agreements;

-- promotion of increased investment in commodity industries;

-- negotiation of a Common Fund to facilitate financing of individual commodity agreements; and

-- more effective operation of the Compensatory Finance Facility of the International Monetary Fund to buffer the effects of fluctuations in a country's export earnings.

The United States is now a member of the Coffee, Sugar and Tin Agreements, each of which embody market intervention mechanisms and rely to some extent on commodity stocking to achieve their price stabilizing objectives. The United States joined the Coffee Agreement in the 1960s and became a member of the Tin Agreement in 1976 after participating in its negotiation a year earlier.

Negotiation of the Sugar Agreement, with the United States playing a major role, took place in 1977 and the Senate ratified the Agreement late last year. The President is expected to sign implementing legislation shortly. Early this year, Congress authorized a voluntary U.S. contribution to the Tin Agreement to help stabilize its world price and we are now making arrangements to transfer the tin to the buffer stock manager.

Price Performance in the Natural Rubber Market

Under Secretary Cooper has explained the nature of the natural rubber industry, and its relationship to the synthetic market. The corollary of this description of the structure of the market is the volatility in prices of natural rubber. This volatility is well documented in the recent World Bank study which showed that rubber ranked tenth in volatility out of 40 commodities examined. A brief review of price movements of natural rubber corroborates this view. Between 1960 and 1968, the New York price declined in an irregular fashion from an annual average of 38 cents per pound to 20 cents. It rose to 26 cents in 1969 before resuming its downward trend to just under 16.5 cents in 1972. The attached table and chart show that within a period of 22 months, price more than tripled to a new peak over 55 cents in early 1974, then dropped precipitously to below 27 cents within ten months. Since then, the price has proceeded on a steady upward movement, reaching nearly 80 cents a pound this past February. In March, price fell to about 74 cents and now stands at about 70 cents a pound.

Because of their concerns about these price fluctuations, in particular the precipitous drop in 1974, producing countries reached an agreement among themselves three years ago. This agreement established a small buffer stock and provided for heavy reliance on export controls to support prices during any future downturn. It was only after importing countries demonstrated sincere interest in negotiating a producer-consumer agreement that the producers agreed to hold their own agreement in abeyance.

All countries agree that the producer-consumer natural rubber agreement which emerged last October will be more effective in stabilizing the prices of natural rubber and provide a better balance of benefits than the go-it-alone producer approach. Unlike cartel-type arrangements, the stabilization mechanisms in this agreement, and key decisions to be taken inside the Rubber Council, place the economic interests of consumers as well as producers on an equal footing. The producing countries, recognizing the benefits in the cooperative approach, have agreed to abandon their Agreement when the new International Natural Rubber Agreement enters into force. This positive move away from an OPEC style cartel, is a significant benefit to members of the Natural Rubber Agreement.

Characteristics of an Economically Viable Price Stabilization Agreement.

We believe price stabilization agreements should operate wherever possible through buffer stocks, and this approach was adopted by the international community early-on in the natural

rubber negotiations. A properly structured buffer stock is more effective and operates more rapidly than any other approach in providing balanced price stabilization, without distorting markets or production patterns. Under this procedure, when demand is temporarily depresssed producers can continue to produce and export their commodities at prices which generally cover their costs, while in times of excess demand, consumers will continue to have access to stocks to draw on at a fair price. Purchasing when prices are low and selling when prices are high, we expect the buffer stock to make profits which will help cover operating costs. Any remaining profits, as well as contributions made to the Natural Rubber Agreement, will be returned to governments upon termination of the Agreement.

We prefer buffer stocks to supply control mechanisms because a stocking approach allows the price mechanism wide latitude in encouraging the most efficient producers to maintain and expand production. However, there are three basic criteria which must be met for this, our preferred approach, to be implemented for any given commodity. First, the international price must be established in open markets; second, the commodity should be either non-perishable or easily rotated in storage facilities so that stock maintenance is feasible and carrying costs do not become exorbitant; third, the commodity should be relatively homogeneous in the sense that most trading takes place in well-defined grades whose prices move roughly in parallel.

There is a wide consensus that the new International Natural Rubber Agreement meets all of the requirements of an economically

viable agreement and is in full accord with our commodity policy. There are a number of reasons to support this as Under Secretary Cooper has indicated. I would like to expand on four interrelated factors which I believe enhance the economic viability of this agreement.

-- First, as Under Secretary Cooper has pointed out, we believe the size of the buffer stock, 550,000 tons, is large enough to provide effective stabilization of rubber prices without the need for supply controls. There is no provision for the use of supply controls. With regard to the buffer stock, our in-house analytical work indicates that had its 550,000 MT. capability been in place during the 1973-75 boom/bust cycle in rubber prices, buffer stock operations would have provided benefits to producers and consumers alike. For example, we have estimated that for every 100,000 MT. of natural rubber bought or sold, natural rubber prices would have moderated by roughly 2 to 2.5 cents per pound per year. A price reduction of this amount during the 1974 peak would have provided a savings of about $35 million in the value of imports of natural rubber in 1974. Such stocking activity would not have entirely eliminated price swings during this boom/bust cycle, nor would they be expected to do so. But they would have moderated the extreme increases and and decreases in price which were experienced.

-- Second, the Agreement builds on the price stabilizing potential of the buffer stock mechanism with provisions for producing countries to implement policies to ensure availability of rubber supplies. In this connection, it is important to note that subsequent to the negotiations, Malaysia changed its tax structure, increasing taxes on palm oil slightly while reducing rubber export taxes. We are pleased with this change and hope that it represents a first step of governments efforts to increase supply. In addition, the Council may make specific recommendations to governments on policies affecting supply and demand for rubber and may request consultations with producing countries to review any such measures. We think these provisions are beneficial because they can stimulate governments to take actions to enhance supply and generally improve the industry's ability to adjust to structural changes in the market.

-- Third, the Agreement provides the necessary financial commitments, equally from producers and consumers, to ensure that the full stock can be bought, held and sold when needed. Financial responsibility within the two groups is shared equitably, as are voting rights. Each are based on each country's share of exports or imports respectively. The U.S. share, an estimated $88 million, is the largest of the importing countries reflecting its position as the leading consumer country accounting for 12-15 percent of total trade. On the producer side,

Malaysia will be responsible for a financial obligation of about 24 percent, a share which is roughly double that of the U.S. and is proportional to its share of trade of natural rubber.

-- Fourth, this Agreement is unique among existing Commodity Agreements in that the provision for wide price range, combined with semi-automatic changes in its reference price and price bands on the downside as well as the upside, will ensure that the buffering mechanism complements the trend of the market rather than artificially regulating the price. Consequently, we can expect to preserve the best features of freely operating markets while reducing the disruptive effects of price volatility.

Overall, this Agreement is expected to be an effective instrument in stabilizing natural rubber markets which in turn will promote production on the supply side and broader natural rubber markets on the demand side. Although we cannot expect dramatic changes in natural rubber markets immediately, we expect the Agreement to be an important element in moderating swings in the price of natural rubber over the medium term.

In achieving this high degree of success in negotiating an effective agreement, we should recognize the spirit of cooperation among the participants in the conference. The major natural rubber suppliers from Southeast Asia -- in particular Malaysia, Indonesia, Thailand, Singapore and Sri Lanka -- worked long and hard to assure a successful outcome. Those countries fully appreciate that stabilization will promote a more efficient industry.

Conclusion

In conclusion, I would like to reemphasize that the Administration is strongly committed to an international commodity policy which will help fight inflation in the United States and worldwide. We have made substantial progress in implementing it. This Natural Rubber Agreement will become a strong component of that policy, and represents a serious cooperative effort between importing and exporting countries. It will lead to the abandonment of a producer-only natural rubber arrangement and we expect the agreement to moderate natural rubber price fluctuations over the long run and be well worth the modest cost to the United States.

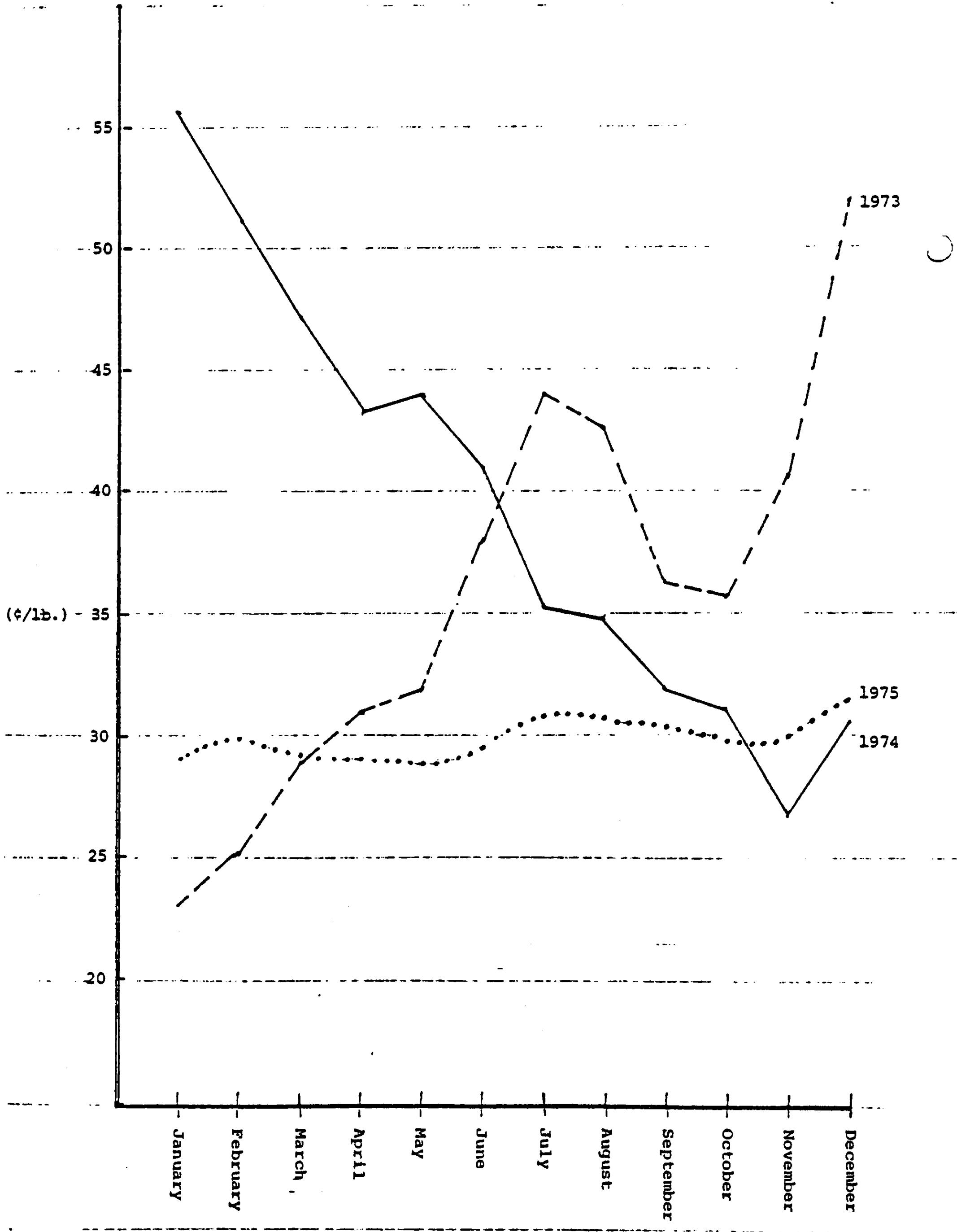
Table 1

New York RSS1 Prices Per Pound

(1973 - 1975 Monthly Average)

	1973	1974	1975
January	23.0	55.5	29.0
February	25.1	51.1	29.9
March	28.8	47.2	29.3
April	30.8	43.1	29.0
May	31.7	43.9	28.8
June	37.8	40.1	29.5
July	43.9	35.2	30.9
August	42.5	34.7	30.7
September	36.3	31.9	30.3
October	35.6	31.1	29.7
November	40.6	26.8	29.9
December	51.9	30.5	31.4
Year	35.7	39.3	29.9

Natural Rubber Prices: New York RSS1, cents per pound (1973-1975, Monthly Avg.)



Department of the TREASURY
NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
April 22, 1980

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UNITED STATES AND REPUBLIC OF CYPRUS
SIGN INCOME TAX CONVENTION

The Treasury Department announced today the signing of an Income Tax Convention between the United States and the Republic of Cyprus in Nicosia, Cyprus, on March 26, 1980. There is presently no such agreement in force between the two countries. A Convention with Cyprus which was signed in 1974 was not sent forward for ratification, and was replaced by the recently signed Convention. The Convention is being submitted to the Senate for its advice and consent to ratification.

The primary objective of the Convention is to promote economic relations between the two countries and to remove tax barriers to the flow of goods, investment and technology and the movement of businessmen, technicians and scholars. The Convention establishes rules for the taxation of business, personal service and investment income earned by residents of one country from sources in the other. The Convention provides also for non-discriminatory tax treatment and reciprocal administrative cooperation to avoid double taxation and prevent fiscal evasion.

The proposed Convention with Cyprus is similar in most essential aspects to other recent United States income tax conventions. There are several variations which, in general, either reflect Cyprus' status as a developing country or are designed to accommodate particular features of Cyprus law. For example, under Cypriot law, non-Cypriot individuals and corporations are entitled to certain tax benefits if they operate outside of Cyprus through a Cypriot base. The Convention has been designed, by the inclusion of special provisions, to assure that concessions granted by the United States accrue to the benefit only of residents of Cyprus and not to third country residents.

The Convention will enter into force upon the exchange of instruments of ratification. The provisions of the Convention will take effect in respect of income of taxable years beginning on or after the first day of January of the next year following the year in which the Convention enters into force.

Attached is a copy of the Convention.

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CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE REPUBLIC OF CYPRUS FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of the Republic of Cyprus, desiring to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, have agreed as follows:

Article 1

TAXES COVERED

(1) The taxes which are the subject of this Convention are:

(a) In the case of the United States, the Federal income taxes imposed by the Internal Revenue Code and the excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations, but excluding the accumulated earnings tax and the personal holding company tax (the United States tax). The excise tax imposed on insurance premiums paid to foreign insurers is covered, however, only to the extent that the foreign insurer does not reinsure such risks with a person not entitled to exemption from such tax under this or another convention.

(b) In the case of Cyprus, The Income Tax and The Special Contribution (the Cypriot Tax).

(2) This Convention shall also apply to taxes substantially similar to those covered by paragraph (1) which are imposed in addition to, or in place of, existing taxes after the date of signature of this Convention.

(3) For the purpose of Article 7 (Non-Discrimination), this Convention shall also apply to taxes of every kind imposed at the national, state, or local level. For the purpose of Article 28 (Exchange of Information), this Convention shall also apply to taxes of every kind imposed at the national level.

Article 2

GENERAL DEFINITIONS

(1) In this Convention, unless the context otherwise requires:

(a) The term "United States" means the United States of America and when used in a geographical sense includes the states thereof and the District of Columbia, the territorial waters of the United States, and any area outside the states and the District of Columbia which in accordance with international law and the laws of the United States is an area within which the rights of the United States with respect to the natural resources of the seabed and subsoil may be exercised;

(b) The term "Cyprus" means the Republic of Cyprus and when used in a geographical sense includes the territorial waters of Cyprus and any area outside Cyprus which in accordance with international law and the laws of Cyprus is an area within which the rights of Cyprus with respect to the natural resources of the seabed and subsoil may be exercised;

(c) The term "Contracting State" means the United States or Cyprus, as the context requires;

(d) The term "person" includes an individual, a partnership, a corporation, an estate, a trust, or any other body of persons;

(e) (i) The term "United States corporation" or "corporation of the United States" means a corporation which is created or organized under the laws of the United States or any state thereof or of the District of Columbia, or any unincorporated entity treated as a United States corporation for United States tax purposes; and

(ii) The term "Cypriot corporation" or "corporation of Cyprus" means an entity (other than a United States corporation) treated as a body corporate for tax purposes under the laws of Cyprus, which is resident in Cyprus for the purposes of Cypriot tax;

(f) The term "competent authority" means:

(i) In the case of the United States, the Secretary of the Treasury or his delegate; and

(ii) In the case of Cyprus, the Minister of Finance or his authorized representative;

(g) The term "State" means any National State, whether or not a Contracting State;

(h) The term "international traffic" means any transport by ship or aircraft, except where such transport is solely between places in the other Contracting State;

(i) The reference to a rate of tax or tax burden which is "substantially less than" means less

(2) Any other term used in this Convention and not defined in this Convention shall, unless the context otherwise requires, have the meaning which it has under the laws of the Contracting State whose tax is being determined. Notwithstanding the preceding sentence, if the meaning of such a term under the laws of a Contracting State is different from the meaning of the term under the laws of the other Contracting State, or if the meaning of such a term is not readily determinable under the laws of a Contracting State, the competent authorities of the Contracting States may, in order to prevent double taxation or to further any other purpose of this Convention, establish a common meaning of the term for the purpose of this Convention.

Article 3

FISCAL RESIDENCE

(1) In this Convention:

(a) The term "resident of Cyprus" means:

(i) A Cypriot corporation; and

(ii) Any person (except a corporation) resident in Cyprus for the purposes of its tax, but in the case of income derived or paid by a partnership, estate, or trust this term applies only to the extent that the income derived by such person is subject to Cypriot tax as the income of a resident either in its hands or in the hands of its partners or beneficiaries.

(b) The term "resident of the United States" means:

(i) A United States corporation; and

(ii) A United States citizen and any person (except a corporation) resident in the United States for the purposes of its tax, but in the case of income derived or paid by a partnership, estate, or trust this term applies only to the extent that the income derived by such person is subject to United States tax as the income of a resident either in its hands or in the hands of its partners or beneficiaries.

(2) Where by reason of the provisions of paragraph (1) an individual is a resident of both Contracting States:

(a) He shall be deemed to be a resident of that Contracting State in which he maintains his permanent home. If he has a permanent home in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of that Contracting State with which his personal and economic relations are closer (center of vital interests);

(b) If his center of vital interests is in neither of the Contracting States or cannot be determined, he shall be deemed to be a resident of that Contracting State in which he has a habitual abode;

(c) If he has a habitual abode in both Contracting States or in neither of the Contracting States, he shall be deemed to be a resident of the Contracting States of which he is a citizen; and

(d) If he is a citizen of both Contracting States or of neither Contracting State the competent authorities of the Contracting States shall settle the question by mutual agreement.

(3) Subject to the provisions of paragraph 1(b) of Article 21 (Students and Trainees), an individual who is deemed to be a resident of a Contracting State and not a resident of the other Contracting State by reason of the provisions of paragraph (2) shall be deemed to be a resident only of the first-mentioned Contracting State for all purposes of this Convention including Article 4 (General

(4) Where by reason of the provisions of paragraph (1) a person other than an individual or a corporation is a resident of both Contracting States, the competent authorities of the Contracting States shall by mutual agreement endeavor to settle the question and to determine the mode of application of the Convention to such person.

Article 4

GENERAL RULES OF TAXATION

(1) A resident of a Contracting State may be taxed by the other Contracting State on any income from sources within that other Contracting State and only on such income, subject to any limitations set forth in this Convention. For this purpose, the rules set forth in Article 6 (Source of Income) shall be applied to determine the source of income.

(2) The provisions of this Convention shall not be construed to restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded:

(a) By the laws of a Contracting State in the determination of the tax imposed by that Contracting State; or

(b) By any other agreement between the Contracting States.

(3) Notwithstanding any provisions of this Convention except paragraph (4) of this Article, a Contracting State may tax a citizen or resident of that Contracting State as if this Convention had not come into effect. For this purpose the term "citizen" shall include a former citizen whose loss of citizenship had as one of its principal purposes the avoidance of income tax, but only for a period of 10 years following such loss.

(4) The provisions of paragraph (3) shall not affect:

(a) The benefits conferred by a Contracting State under Article 5 (Relief from Double Taxation), 7 (Non-Discrimination), 24 (Social Security Payments), and 27 (Mutual Agreement Procedure); and

(b) The benefits conferred by a Contracting State under Articles 21 (Students and Trainees) and 22 (Governmental Functions) upon individuals who are neither citizens of, nor have immigrant status in, that Contracting State.

(5) Where, pursuant to any provision of this Convention, a Contracting State reduces the rate of tax on, or exempts, income of a resident of the other Contracting State and under the law in force in that other Contracting State the resident is subject to tax by that other Contracting State only on that part of such income which is remitted to or received in that other Contracting State, then the reduction or exemption shall apply only to so much of such income as is remitted to or received in that other Contracting State during the calendar year such income is paid or the next succeeding calendar year.

(6) Where, pursuant to any provision of this Convention other than paragraph 1 of Article 23 (Private Pensions and Annuities), a Contracting State reduces the rate of tax on, or exempts, income of a person (other than a corporation) who is a resident of the other Contracting State and under the law in force in that other Contracting State such income is subject to a rate of tax or tax burden which is substantially less than the tax which generally would be imposed by that Contracting State on such income if derived from sources within that Contracting State, then the reduction of exemption to be allowed under this Convention in the first-mentioned Contracting State shall not apply.

Article 5

RELIEF FROM DOUBLE TAXATION

Double taxation of income shall be avoided in the following manner:

(1) In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the principles hereof), the United States shall allow to a citizen or resident of the United States as a credit against the United States tax the appropriate amount of the Cypriot tax. However, no such credit shall be allowed with respect to dividends paid by a Cypriot corporation to a resident of the United States, other than a United States corporation owning at least 10 percent of the voting power of such Cypriot corporation. In the case of such a United States corporation, the United States shall allow as a credit against the United States tax on income the appropriate amount of the Cypriot tax paid by the Cypriot corporation with respect to the profits out of which the dividends are paid to the United States corporation. Where a credit is allowed pursuant to this paragraph, such appropriate amount shall be based upon the amount of the Cypriot tax paid, but the credit shall not exceed the limitations provided by United States law for the taxable year. For the purpose of applying the United States credit in relation to taxes paid to Cyprus, the rules set forth in Article 6 (Source of Income) shall be applied to determine the source of income.

(2) In accordance with the provisions and subject to the limitations of the law of Cyprus (as it may be amended

from time to time without changing the principles hereof), Cyprus shall allow to a citizen or resident of Cyprus as a credit against the Cypriot tax the appropriate amount of the United States tax and, in the case of a Cypriot corporation owning at least 10 percent of the voting power of a United States corporation from which it received dividends in any taxable year, shall allow credit for the appropriate amount of the United States tax paid by the United States corporation paying such dividends with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of the United States tax paid but shall not exceed that portion of the Cypriot tax, as computed before the credit is given, which is applicable to such items of income. For the purpose of applying the Cypriot credit in relation to taxes paid to the United States, the rules set forth in Article 6 (Source of Income) shall be applied to determine the source of income.

Article 6

SOURCE OF INCOME

For purposes of this Convention:

(1) Dividends shall be treated as income from sources within a Contracting State only if paid by a corporation of that Contracting State. Notwithstanding the preceding sentence, if the dividends are described in paragraph 4(b) of Article 12 (Dividends), they shall be deemed to be from sources within the United States.

(2) Interest shall be treated as income from sources within a Contracting State only if paid by such Contracting State, a political subdivision or a local authority thereof, or by a resident of that Contracting State. Notwithstanding the preceding sentence, and except for interest described in paragraph 7(c) of Article 13 (Interest) which shall be deemed to be from sources within the United States:

(a) If the person paying the interest (whether or not such person is a resident of a Contracting State) has a permanent establishment in a Contracting State in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment; or

(b) If the person paying the interest is a resident of a Contracting State and has a permanent

establishment in a State (other than a Contracting State) in connection with which the indebtedness on which the interest is paid was incurred, and such interest is borne by such permanent establishment

such interest shall be deemed to be from sources within the State in which the permanent establishment is situated.

(3) Royalties described in paragraph (2) of Article 14 (Royalties) for the use of, or the right to use, property or rights described in such paragraph shall be treated as income from sources within a Contracting State only to the extent that such royalties are for the use of, or the right to use, such property or rights within the Contracting State.

(4) Income from real property (including royalties), described in Article 15 (Income from Real Property), shall be treated as income from sources within a Contracting State only if such property is situated in that Contracting State.

(5) Income from the rental of tangible personal (movable) property shall be treated as income from sources within a Contracting State only if such property is used in that Contracting State.

(6) Income received by an individual for his performance of labor or personal services, whether as an employee or in an independent capacity, shall be treated as income from sources within a Contracting State only to the extent that such services are performed in that Contracting State. Notwithstanding the preceding sentence, income from personal services performed aboard ships or aircraft

operated by a resident of a Contracting State in international traffic shall be treated as income from sources only within that Contracting State if rendered by a member of the regular complement of the ship or aircraft. For the purposes of this paragraph, income from labor or personal services includes pensions (as defined in paragraph (3) of Article 23 (Private Pensions and Annuities)) paid in respect of such services. Notwithstanding the preceding provisions of this paragraph:

(a) Remuneration described in Article 22 (Governmental Functions) and payments described in Article 24 (Social Security Payments) shall be treated as income from sources within a Contracting State only if paid by or from the public funds of that Contracting State or a political subdivision or local authority thereof; and

(b) The portion of directors' fees taxable in a Contracting State under Article 20 (Directors' Fees) shall be treated as income from sources within such Contracting State.

(7) Income from the purchase and sale of intangible or tangible personal (including movable) property (other than gains defined as royalties by paragraph (2)(b) of Article 14 (Royalties)) shall be treated as income from sources within a Contracting State only if such property is either sold in that Contracting State or is property described in paragraph (1)(b) or (c) of Article 16 (Capital Gains) and the real property is located in that Contracting State.

(8) Notwithstanding paragraphs (1) through (7), industrial or commercial profits which are attributable to a permanent establishment which the recipient, a resident of a Contracting State, has in the other Contracting State, including income derived from real property and natural resources and dividends, interest, royalties (as defined in paragraph (2) of Article 14 (Royalties)), and capital gains, but only if the property or rights giving rise to such income, dividends, interest, royalties, or capital gains are effectively connected with such permanent establishment, shall be treated as income from sources within that other Contracting State.

(9) The source of any item of income to which paragraphs (1) through (8) are not applicable shall be determined by each of the Contracting States in accordance with its own law. Notwithstanding the preceding sentence, if the source of any item of income under the laws of one Contracting State is different from the source of such item of income under the laws of the other Contracting State or if the source of such income is not readily determinable under the laws of a Contracting State, the competent authorities of the Contracting States may, in order to prevent double taxation or further any other purpose of this Convention, establish a common source of the item of income for the purposes of this Convention.

Article 7

NON-DISCRIMINATION

(1) A citizen of a Contracting State shall not be subjected in the other Contracting State to more burdensome taxes than a citizen of that other Contracting State who is in similar circumstances. For purposes of United States taxation, United States citizens who are not resident in the United States and Cypriot citizens who are not resident in the United States are not in similar circumstances.

(2) A permanent establishment which a resident of a Contracting State has in the other Contracting State shall not be subject in that other Contracting State to more burdensome taxes than a resident of that other Contracting State carrying on similar activities. This paragraph shall not be construed as obliging a Contracting State to grant to individual residents of the other Contracting State any personal allowances, reliefs, or deductions for taxation purposes on account of civil status or family responsibilities which it grants to its own individual residents.

(3) Except where the provisions of paragraph 1 of Article 11 (Related Persons), paragraph 5 of Article 13 (Interest), or paragraph 4 of Article 14 (Royalties) apply, interest, royalties and other disbursements paid by a resident of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of the first-mentioned resident, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned Contracting State. For purposes of this paragraph, the term "other disbursements" shall include charges for amounts expended by a resident of a Contracting State for purposes of a resident

of the other Contracting State, including a reasonable allocation of executive and general administrative expenses (except to the extent representing the expenses of a type of activity which is not for the benefit of the resident of the other Contracting State, but constitute "stewardship" or "over-seeing" functions undertaken for the first mentioned resident's own benefit as an investor), research and development, and other expenses incurred by such resident for the benefit of a group of related persons including such resident. Similarly, any debts of a resident of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such first-mentioned resident, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned Contracting State.

(4) A corporation of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar corporations of the first-mentioned Contracting State are or may be subjected.

Article 8

BUSINESS PROFITS

(1) Industrial or commercial profits of a resident of a Contracting State shall be exempt from tax by the other Contracting State unless such resident is engaged in industrial or commercial activity in that other Contracting State through a permanent establishment situated therein. If such resident is so engaged, tax may be imposed by that other Contracting State on the industrial or commercial profits of such resident but only on so much of such profits as are attributable to the permanent establishment.

(2) Where a resident of a Contracting State is engaged in industrial or commercial activity in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to the permanent establishment the industrial or commercial profits which would be attributable to such permanent establishment if such permanent establishment were an independent entity engaged in the same or similar activities under the same or similar conditions.

(3) In the determination of the industrial or commercial profits of a permanent establishment, there shall be allowed as deductions expenses which are reasonably connected with such profits, including executive and general administrative expenses, whether incurred in the Contracting State in which the permanent establishment is situated or elsewhere.

(4) No profits shall be attributed to a permanent establishment of a resident of a Contracting State in the other Contracting State merely by reason of the purchase of goods or merchandise by that permanent establishment, or by the resident of which it is a permanent establishment, for the account of that resident.

(5) The term "industrial or commercial activity" includes the conduct of manufacturing, mercantile, banking, insurance, agricultural, fishing or mining activities, the operation of ships or aircraft, the furnishing of services and the rental of tangible personal property. Such term does not include the performance of personal services by an individual either as an employee or in an independent capacity.

(6) (a) The term "industrial or commercial profits" means income derived from industrial or commercial activity. The term also includes income derived from real property and natural resources and dividends, interest, royalties (as defined in paragraph (2) of Article 14 (Royalties)), and capital gains but only if the property or rights giving rise to such income, dividends, interest, royalties, or capital gains is effectively connected with a permanent establishment which the recipient, being a resident of a Contracting State, has in the other Contracting State, whether or not such income is derived from industrial or commercial activity.

(b) To determine whether property or rights are effectively connected with a permanent establishment, the factors taken into account shall include whether rights or property are used in or held for use in carrying on

industrial or commercial activity through such permanent establishment and whether the activities carried on through such permanent establishment were a material factor in the realization of the income derived from such property or rights. For this purpose, due regard shall be given to whether or not such property or rights or such income were accounted for through such permanent establishment.

(7) Where industrial or commercial profits include items of income which are dealt with separately in other Articles of this Convention, the provisions of those Articles shall, except as otherwise provided therein, supersede the provisions of this Article.

Article 9

PERMANENT ESTABLISHMENT

(1) For purposes of this Convention, the term "permanent establishment" means a fixed place of business through which a resident of a Contracting State engages in industrial or commercial activity.

(2) The term "fixed place of business" includes but is not limited to:

(a) A branch;
(b) An office;
(c) A factory;
(d) A workshop;
(e) A warehouse;
(f) A store or other sales outlet;
(g) A mine, quarry, or other place of extraction of natural resources; and
(h) A building site or construction or installation project which exists for more than six months.

(3) Notwithstanding paragraphs (1) and (2), a permanent establishment shall not include a fixed place of business used only for one or more of the following:

(a) The use of facilities for the purpose of storage, display, or delivery of goods or merchandise belonging to the resident;

(b) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of storage, display, or delivery;

(c) The maintenance of a stock of goods or merchandise belonging to the resident for the purpose of processing by another person;

(d) The maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the resident;

(e) The maintenance of a fixed place of business for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the resident; or

(f) The maintenance of a building site or construction or installation project which does not exist for more than six months.

(4) A person acting in a Contracting State on behalf of a resident of the other Contracting State, other than an agent of an independent status to whom paragraph (5) applies, shall be deemed to be a permanent establishment in the first-mentioned Contracting State if such person has, and habitually exercises in the first-mentioned Contracting State, an authority to conclude contracts in the name of that resident, unless the activities of such person are limited to those mentioned in paragraph (3) which, if exercised through a fixed place of business, would not make the fixed place of business a permanent establishment under the provisions of that paragraph.

(5) A resident of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because such resident engages in industrial or commercial activity in that other Contracting State through a broker, general commission agent, or any other agent of an independent status, where such broker or agent is acting in the ordinary course of his business.

(6) The fact that a resident of a Contracting State is a related person (within the meaning of Article 11 (Related Persons)) with respect to a resident of the other Contracting State or with respect to a person who engages in industrial or commercial activity in that other Contracting State (whether through a permanent establishment or otherwise) shall not be taken into account in determining whether that resident of the first-mentioned Contracting State has a permanent establishment in that other Contracting State.

(7) The principles set forth in paragraphs (1) through (6) shall be applied in determining for the purposes of this Convention whether there is a permanent establishment in a State other than a Contracting State or whether a person other than a resident of a Contracting State has a permanent establishment in a Contracting State.

Article 10

SHIPPING AND AIR TRANSPORT

(1) Notwithstanding Articles 8 (Business Profits) and 16 (Capital Gains), income which a resident of a Contracting State derives from the operation in international traffic of ships or aircraft, including gains derived from the sale, exchange, or other disposition of such ships or aircraft, shall be exempt from tax by the other Contracting State.

(2) For purposes of this Article, profits from the operation in international traffic of ships or aircraft include profits derived from the rental on a full or bare-boat basis of ships or aircraft if operated in international traffic by the lessee or if such rental profits are incidental to other profits described in paragraph (1).

(3) Profits of a resident of a Contracting State from the use, maintenance or rental of containers (including trailers, barges, and related equipment for the transport of containers) used for the transport in international traffic of goods or merchandise shall be taxable only in that Contracting State.

(4) For purposes of paragraphs (1) and (3) of this Article, a corporation which is a United States corporation or a Cypriot corporation will not be considered to be a resident of the United States or Cyprus, as the case may be, if twenty-five percent or more of the capital of such corporation is held of record or is otherwise determined, after consultation between the competent authorities of

the Contracting State, to be owned directly or indirectly by one or more persons who are not individual residents cf the United States or Cyprus, as the case may be (or, in the case of a Cypriot corporation, who are citizens of the United States). For purposes of this paragraph, a corporation that has substantial trading in its stock on a recognized exchange in a Contracting State is presumed to be owned by individual residents of that Contracting State.

Article 11

RELATED PERSONS

(1) Where a person subject to the taxing jurisdiction of a Contracting State and any other person are related and where such related persons make arrangements or impose conditions between themselves which are different from those which would be made between independent persons, any income, deductions, credits, or allowances which would, but for those arrangements or conditions, have been taken into account in computing the income (or loss) of, or the tax payable by, one of such persons, may be taken into account in computing the amount of the income subject to tax and the taxes payable by such person.

(2) For purposes of this Convention, a person is related to another person if either person owns or controls directly or indirectly the other, or if any third person or persons own or control directly or indirectly both. For this purpose, the term "control" includes any kind of control, whether or not legally enforceable, and however exercised or exercisable.

(3) Where an adjustment has been made by a Contracting State in accordance with paragraph (1), the other Contracting State shall, if it agrees that the adjustment by the first-mentioned Contracting State was in accordance with paragraph (1), make a corresponding adjustment to the income, loss or tax of the related person in that other Contracting State.

In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.

Article 12

DIVIDENDS

(1) Dividends derived from sources within Cyprus by a resident of the United States shall not be subject to any tax imposed by Cyprus in excess of the tax imposed with respect to the profits or earnings out of which such dividends are paid. An individual resident of the United States shall be entitled to a refund of any Cypriot tax imposed with respect to the profits or earnings out of which a dividend is paid to the extent that said tax exceeds the individual's tax liability in Cyprus.

(2) The rate of tax imposed by the United States on dividends, other than dividends of the type described in paragraph 4(b), derived from sources within the United States by a resident of Cyprus shall not exceed:

(a) 15 percent of the gross amount of the dividend; or

(b) When the recipient is a corporation, 5 percent of the gross amount of the dividend if:

(i) During the part of the paying corporation's taxable year which precedes the date of payment of the dividend and during the whole of its prior taxable year (if any), at least 10 percent of the outstanding shares of the voting stock of the paying corporation was owned by the recipient corporation; and

(ii) Not more than 25 percent of the gross income of the paying corporation for such prior taxable year (if any) consists of interest or dividends (other than interest derived from the conduct of a banking, insurance, or financing business and dividends or interest received from subsidiary corporations, 50 percent or more of the outstanding shares of the voting stock of which is owned by the paying corporation at the time such dividends or interest is received).

(3) Paragraphs (1) and (2) shall not apply if the recipient of the dividends, being a resident of a Contracting State, has in the other Contracting State a permanent establishment and the shares with respect to which the dividends are paid are effectively connected with such permanent establishment. In such a case, the provisions of Article 8 (Business Profits) shall apply.

(4) Dividends paid by a corporation of a Contracting State to a person other than a resident of the other Contracting State shall be exempt from tax by the other Contracting State, unless

(a) The recipient of the dividends has a permanent establishment in the other Contracting State and the shares with respect to which the dividends are paid are effectively connected with such permanent establishment; or

(b) The corporation paying the dividends is a Cypriot corporation which derives more than 50 percent of its profits from one or more permanent establishments which such corporation has in the United States

and more than 25 percent of the capital of such corporation is owned directly or indirectly by individuals who are not citizens of Cyprus.

Article 13

INTEREST

(1) Interest derived from sources within a Contracting State by a resident of the other Contracting States may be taxed by both Contracting States.

(2) The rate of tax imposed by a Contracting State on interest, other than interest described in paragraph 7(c) of this Article, derived from sources within that Contracting State by a resident of the other Contracting State shall not exceed 10 percent of the gross amount of such interest.

(3) Notwithstanding paragraphs (1) and (2), interest beneficially derived by:

(a) A Contracting State, or an instrumentality of that Contracting State not subject to tax by that Contracting State on its income;

(b) A resident of a Contracting State with respect to debt obligations (including any related debt obligations) guaranteed or insured by that Contracting State or an instrumentality thereof;

(c) A bank or other financial institution; or

(d) A resident of a Contracting State with respect to debt obligations arising in connection with the sale of property or the performance of services;

shall be exempt from tax by the other Contracting State.

(4) Paragraphs (2) and (3) shall not apply if the recipient of the interest, being a resident of a Contracting State, has a permanent establishment in the other Contracting State and the indebtedness giving rise to the interest is effectively connected with such permanent establishment. In such a case, the provisions of Article 8 (Business Profits) shall apply.

(5) Where any interest paid by a person to any related person (within the meaning of Article 11 (Related Persons)) exceeds an amount which would have been paid to an unrelated person, the provisions of this Article shall apply only to so much of the interest as would have been paid to an unrelated person. In such a case the excess payment may be taxed by each Contracting State according to its own law, including the provisions of this Convention where applicable.

(6) The term "interest" as used in this Convention means income from bonds, debentures, government securities, notes, or other evidences of indebtedness, whether or not secured and whether or not carrying a right to participate in profits, and debt-claims of every kind, as well as all other income which, under the taxation law of the Contracting State in which the income has its source, is assimilated to income from money lent.

(7) Interest paid by a resident of a Contracting State to a person other than a resident of the other Contracting State shall be exempt from tax by the other Contracting State, unless:

(a) Such interest is treated as income from sources within the other Contracting State under paragraph (2) of Article 6 (Source of Income);

(b) The recipient of the interest has a permanent establishment in the other Contracting State and the indebtedness giving rise to the interest is effectively connected with such permanent establishment; or

(c) The resident paying the interest is a Cypriot corporation which derives more than 50 percent of its profits from one or more permanent establishments which such corporation has in the United States and more than 25 percent of the capital of such corporation is owned directly or indirectly by individuals who are not citizens of Cyprus.

Article 14

ROYALTIES

(1) Royalties derived from sources within a Contracting State by a resident of the other Contracting State shall be exempt from tax by the first-mentioned Contracting State.

(2) The term "royalties" as used in this Artic e means:

(a) Payment of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works, cinematograph films including films and video tapes for television broadcasting, patents, designs, models, plans, secret processes or formulae, trademarks, or other like property or rights, or knowledge, experience, or skill (know-how); and

(b) Gains derived from the sale, exchange, or other disposition of any such property or rights to the extent that the amounts realized on such sale, exchange, or other disposition for consideration are contingent on the productivity, use, or disposition of such property or right.

(3) Paragraph (1) shall not apply if the recipient of the royalties, being a resident of a Contracting State, has a permanent establishment in the other Contracting State and the property or rights giving rise to the royalties are effectively connected with such permanent establishment. In

such a case, the provisions of Article 8 (Business Profits) shall apply.

(4) Where any royalty paid by a person to any related person (within the meaning of Article 11 (Related Persons)) exceeds an amount which would have been paid to an unrelated person, the provisions of this Article shall apply only to so much of the royalty as would have been paid to an unrelated person. In such a case the excess payment may be taxed by each Contracting State according to its own law, including the provisions of this Convention where applicable.

Article 15

INCOME FROM REAL PROPERTY

(1) Income from real property, including royalties and other payments in respect to the exploitation of natural resources and gains derived from the sale, exchange, or other disposition of such property or of the right giving rise to such royalties or other payments, may be taxed by the Contracting State in which such real property or natural resources are situated. For purposes of this Convention, interest on indebtedness secured by real property or secured by a right giving rise to royalties or other payments in respect of the exploitation of natural resources shall not be regarded as income from real property.

(2) Paragraph (1) shall apply to income derived from the usufruct, direct use, letting, or use in any other form of real property.

(3) A resident of a Contracting State who is subject to tax in the other Contracting State on income from real property, including royalties and other payments in respect of the exploitation of natural resources and gains derived from the sale, exchange or other disposition of such property or of the right giving rise to such royalties, may elect for any taxable year to compute that tax on such income on a net basis as if such resident were engaged in trade or business in the other Contracting State. Any such election shall be binding for the taxable year of the election and all subsequent taxable years unless the competent authorities of the two Contracting States, pursuant to a request by the taxpayer made to the competent authority of the Contracting State in which the taxpayer is a resident, agree to terminate the election.

Article 16

CAPITAL GAINS

(1) A resident of a Contracting State shall be exempt from tax by the other Contracting State on gains from the sale, exchange or other disposition of capital assets unless the gain is derived from the sale, exchange or other disposition of:

(a) Real property situated within the other Contracting State;

(b) Shares of the capital stock of a corporation the property of which consists principally of property described in subparagraph (a);

(c) An interest in a partnership, trust or estate the property of which consists principally of property described in subparagraph (a); or

(d) Property (other than property described in subparagraphs (a), (b) and (c)) forming part of the business property of a permanent establishment which a resident of a Contracting State has in the other Contracting State or property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise) or of such fixed base.

For purposes of this paragraph, "property described in subparagraph (a)" includes the shares of a corporation, or an interest in a partnership, trust or estate, the property of which consists principally of property described in subparagraph (a).

(2) In the case of gains described in paragraph 1(a), (b), and (c) the provisions of Article 15 (Income from Real Property) shall apply. In the case of gains described in paragraph 1(d) the provisions of Article 8 (Business Profits), or Article 17 (Independent Personal Services) shall apply, as the case may be.

Article 17

INDEPENDENT PERSONAL SERVICES

(1) Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity may be taxed by that Contracting State. Except as provided in paragraph (2) such income shall be exempt from tax by the other Contracting State.

(2) Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity in the other Contracting State may be taxed by that other Contracting State, if:

(a) The individual is present in that other Contracting State for a period or periods aggregating 183 days or more in the taxable year; or

(b) The individual has a fixed base regularly available to him in that other Contracting State for the purpose of performing his services, but only so much of the income as is attributable to such fixed base.

Article 18

DEPENDENT PERSONAL SERVICES

(1) Wages, salaries, and similar remuneration derived by an individual who is a resident of a Contracting State from labor or personal services performed as an employee, including income from services performed by an officer of a corporation, may be taxed by that Contracting State. Except as provided by paragraph (2), such remuneration derived from sources within the other Contracting State may also be taxed by that other Contracting State.

(2) Remuneration described in paragraph (1) derived by an individual who is a resident of a Contracting State shall be exempt from tax by the other Contracting State if:

(a) He is present in that other Contracting State for a period or periods aggregating less than 183 days in the taxable year;

(b) The remuneration is paid by, or on behalf of, an employer who is not a resident of that other Contracting State; and

(c) The remuneration is not borne as such by a permanent establishment which the employer has in that other Contracting State.

(3) Notwithstanding paragraph (2), remuneration derived by an individual from the performance of labor or personal services as an employee aboard ships or aircraft operated by a resident of a Contracting State in international traffic shall be exempt from tax by the other Contracting State if such individual is a member of the regular complement of the ship or aircraft.

Article 19

ARTISTES AND ATHLETES

(1) Notwithstanding the provisions of Articles 17 (Independent Personal Services) and 18 (Dependent Personal Services), income derived by a resident of a Contracting State as an entertainer, such as a theatre, motion picture, radio or television artiste, or a musician, or as an athlete, from his personal activities as such exercised in the other Contracting State, may be taxed in that other Contracting State, except where the amount of the gross receipts derived by such entertainer or athlete, not including expenses reimbursed to him or borne on his behalf, from such activities does not exceed five hundred United States dollars or its equivalent in Cypriot pounds per day, or five thousand United States dollars or its equivalent in Cypriot pounds for the taxable year concerned.

(2) To the extent that income in respect of activities exercised by an entertainer or an athlete in his capacity as such accrues not to that entertainer or athlete but to another person, that income may, notwithstanding the provisions of Articles 8 (Business Profits), 17 (Independent Personal Services), and 18 (Dependent Personal Services) be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised. For purposes of the preceding sentence, income of an entertainer or athlete shall be deemed not to accrue to another person if it is established that neither the entertainer or athlete, nor persons related thereto, participate directly or indirectly in the profits of such other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions or other distributions.

Article 20

DIRECTORS' FEES

Fees derived by a resident of a Contracting State in his capacity as a member of the board of directors of a corporation of the other Contracting State (but not including fixed or contingent payments derived in his capacity as an officer or employee) may, to the extent such fees are in excess of a reasonable fixed amount for each day of attendance payable to all directors of the corporation for attendance at the directors' meeting in such other Contracting State, be taxable in such other Contracting State.

Article 21

STUDENTS AND TRAINEES

(1) (a) An individual who is a resident of a Contracting State at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State for the primary purpose of:

(i) Studying at a university or other recognized educational institution in that other Contracting State; or

(ii) Securing training required to qualify him to practice a profession or professional specialty; or

(iii) Studying or doing research as a recipient of a grant, allowance, or award from a governmental, religious, charitable, scientific, literary, or educational organization;

shall be exempt from tax by that other Contracting State for a period not exceeding five taxable years from the date of his arrival in that other Contracting State, and for such additional period of time as is necessary to complete, as a full-time student, educational requirements as a candidate for a postgraduate or professional degree from a recognized educational institution, with respect to amounts received for the purpose of his maintenance, education or training, to the extent that such payments arise outside that other Contracting State.

(b) An individual to whom subparagraph (a) applies may elect to be treated for all tax purposes, including this Convention, as a resident of the other Contracting State. The election shall apply to the portion of the taxable year of the election and of subsequent taxable years during which the individual qualifies under subparagraph (a). The benefits of subparagraph (a) are not affected by an election made under this subparagraph.

(2) An individual who is a resident of a Contracting State at the time he becomes temporarily present in the other Contracting State and who is temporarily present in that other Contracting State as an employee of, or under contract with, a resident of the first-mentioned Contracting State, for the primary purpose of:

(a) Acquiring technical, professional, or business experience from a person other than a resident of the first-mentioned Contracting State or other than a person related to such resident; or

(b) Studying at a university or other recognized educational institution in that other Contracting State;

shall be exempt from tax by that other Contracting State for a period not exceeding one year with respect to his income from personal services in an aggregate amount not in excess of seven thousand five hundred United States dollars or its equivalent in Cypriot pounds.

(3) An individual who is a resident of a Contracting State at the time he becomes temporarily present in the other Contracting State and who is temporarily present in the other Contracting State for a period not exceeding one year, as a participant in a program sponsored by the government of that other Contracting State, for the primary purpose of training, research, or study, shall be exempt from tax by that other Contracting State with respect to his income from personal services in respect of such training, research, or study performed in that other Contracting State in an aggregate amount not in excess of ten thousand United States dollars or its equivalent in Cypriot pounds.

Article 22

GOVERNMENTAL FUNCTIONS

Wages, salaries, and similar remuneration, including pensions, annuities, or similar benefits, paid from public funds of a Contracting State to a citizen of that Contracting State for labour or personal services performed as an employee of that Contracting State in the discharge of governmental functions shall be exempt from tax by the other Contracting State.

Article 23

PRIVATE PENSIONS AND ANNUITIES

(1) Except as provided in Article 22 (Governmental Functions) pensions and other similar renumeration paid to an individual who is a resident of a Contracting State in consideration of past employment shall be taxable only in that Contracting State.

(2) Alimony and annuities paid to an individual who is a resident of a Contracting State shall be taxable only in that Contracting State.

(3) The term "pensions and other similar remuneration," as used in this Article, means periodic payments made:

(a) By reason of retirement or death in consideration for services rendered; or

(b) By way of compensation for injuries received in connection with past employment.

(4) The term "annuities", as used in this Article, means a stated sum paid periodically at stated times during life, or during a specified number of years, under an obligation to make the payments in return for adequate and full consideration (other than services rendered).

(5) The term "alimony", as used in this Article, means periodic payments made pursuant to a decree of divorce, separate maintenance agreement, or support or separation agreement which is taxable to the recipient under the internal laws of the Contracting State of which he is a resident.

Article 24

SOCIAL SECURITY PAYMENTS

Social security payments and other public pensions paid by a Contracting State to an individual who is a resident of the other Contracting State or citizen of the United States shall be taxable only in the first-mentioned Contracting State. This Article shall not apply to payments described in Article 22 (Governmental Functions).

Article 25

DIPLOMATIC AND CONSULAR OFFICERS

Nothing in this Convention shall affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements.

Article 26

INVESTMENT OR HOLDING COMPANIES

A corporation of a Contracting State deriving dividends, interest, or royalties from sources within the other Contracting State shall not be entitled to the benefits of Article 12 (Dividends), 13 (Interest) or 14 (Royalties) if:

(a) By reason of special measures the tax imposed on such corporation by the first-mentioned Contracting State with respect to such dividends, interest or royalties, is substantially less than the tax generally imposed by such Contracting State on corporate profits; or

(b) Twenty-five percent or more of the capital of such corporation is held of record or is otherwise determined, after consultation between the competent authorities of the Contracting States, to be owned directly or indirectly by one or more persons who are not individual residents of the first-mentioned Contracting State (or, in the case of a Cypriot corporation, who are citizens of the United States). For purposes of this paragraph, a corporation that has substantial trading in its stock on a recognized exchange in a Contracting State is presumed to be owned by residents of that Contracting State.

Article 27

MUTUAL AGREEMENT PROCEDURE

(1) Where a resident of a Contracting State considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with this Convention, he may, notwithstanding the remedies provided by the national laws of the Contracting States, present his case to the competent authority of the Contracting State of which he is a resident. Should the resident's claim be considered to have merit by the competent authority of the Contracting State to which the claim is made, it shall endeavor to come to an agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation contrary to the provisions of this Convention.

(2) The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the application of this Convention. In particular, the competent authorities of the Contracting States may agree:

(a) To the same attribution of income, deductions, credits or allowances of a resident of a Contracting State to its permanent establishment situated in the other Contracting State;

(b) To the same allocation of income, deductions, credits, or allowances between persons, including a uniform position on the application of the requirements of paragraph (2) of Article 7 (Non-Discrimination);

(c) To the same determination of the source of particular items of income;

(d) To a uniform accounting for income and deductions;

(e) To the same characterization of particular items of income; and

(f) To a common meaning of a term.

The competent authorities may also consult together for the elimination of double taxation in cases not provided for in the Convention.

(3) The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of this Article. When it seems advisable for the purpose of reaching agreement, the competent authorities may meet together for an oral exchange of opinions.

(4) In the event that the competent authorities of the Contracting States reach such an agreement, taxes shall be imposed and refund or credit of taxes shall be allowed by the Contracting States in accordance with such agreement. Such a refund or credit of tax shall be allowed notwithstanding any time limits in the domestic law of the Contracting States.

(5) In cases where this Convention specifies a dollar amount, the competent authorities may agree to a higher dollar amount.

(6) The competent authorities of the Contracting States may prescribe such rules and procedures as are necessary to carry out the purposes of this Convention.

Article 28

EXCHANGE OF INFORMATION

(1) The competent authorities of the Contracting State shall exchange such information as is pertinent to carrying out the provisions of this Convention and of the domestic laws of the Contracting States concerning taxes covered by this Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any persons other than those (including a court or administrative body) concerned with assessment, collection, enforcement, or prosecution in respect of the taxes which are the subject of this Convention.

(2) If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall obtain the information to which the request relates in the same manner and to the same extent as if the tax of the first-mentioned Contracting State were the tax of that other Contracting State and were being imposed by that other Contracting State. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, or writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of such other Contracting State with respect to its own taxes.

(3) In no case shall the provisions of paragraphs (1) or (2) be construed so as to impose on a Contracting State the obligation:

(a) To carry out administrative measures at variance with the laws or the administrative practice of that Contracting State or the other Contracting State;

(b) To supply particulars which are not obtainable under the laws, or in the normal course of the administration, of that Contracting State or of the other Contracting State; or

(c) To supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information, the disclosure of which would be contrary to public policy.

(4) The exchange of information shall be either on a routine basis or on request with reference to particular cases. The competent authorities of the Contracting States may agree on the information which shall be furnished on a routine basis.

(5) The competent authorities of the Contracting States shall notify each other of any amendments of the tax laws referred to in paragraph (1) of Article 1 (Taxes Covered) and of the adoption of any taxes referred to in paragraph (2) of Article 1 (Taxes Covered) by transmitting the texts of any amendments or new statutes.

(6) The competent authorities of the Contracting States shall notify each other of the publication by their respective Contracting States of any material concerning the application of this Convention, whether in the form of regulations, rulings, or judicial decisions, by transmitting the texts of any such materials.

Article 29

ASSISTANCE IN COLLECTION

(1) Each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such taxes imposed by that other Contracting State as will ensure that any exemption or reduced rate of tax granted under this Convention by that other Contracting State shall not be enjoyed by persons not entitled to such benefits.

(2) In no case shall this Article be construed so as to impose upon a Contracting State the obligation to carry out measures at variance with the laws, administrative practices, or public policy of either Contracting State with respect to the collection of its own taxes.

Article 30

ENTRY INTO FORCE

This Convention shall be ratified and instruments of ratification shall be exchanged at Nicosia, Cyprus as soon as possible. It shall enter into force upon the exchange of the instruments of ratification. The provisions shall for the first time have effect with respect to income of taxable years beginning (or in the case of taxes payable at the source, payments made) on or after the first day of January of the year next following the year in which this Convention enters into force.

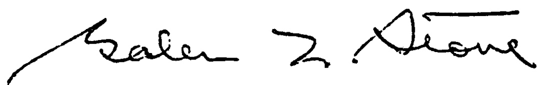
Article 31

TERMINATION

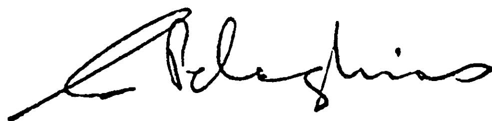
This Convention shall remain in force until terminated by a Contracting State. Either Contracting State may terminate the Convention at any time after five years from the date on which this Convention enters into force provided that at least six months' prior notice of termination has been given through diplomatic channels. In such event, the Convention shall cease to have force and effect as respects income of calendar years or taxable years beginning (or, in the case of taxes payable at the source, payments made) on or after the first day of January next following the expiration of the six-month period.

DONE AT NICOSIA, CYPRUS in duplicate in the English language this 26th Day of March, 1980.

FOR THE UNITED STATES OF AMERICA:



FOR THE REPUBLIC OF CYPRUS:



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Department of the TREASURY

NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE AT 4:00 P.M. April 22, 1980

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $7,000 million, to be issued May 1, 1980. As the regular 13-week and 26-week bill maturities were issued in the amount of $6,409 million, this offering will provide the Treasury about $600 million new cash above the amount maturing through the regular issues. The $6,901 million of additional issue 37-day cash management bills issued March 25 and maturing May 1, 1980, will be redeemed at maturity.

The $6,409 million of regular maturities includes $1,667 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities and $1,868 million currently held by Federal Reserve Banks for their own account. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,500 million, representing an additional amount of bills dated January 31, 1980, and to mature July 31, 1980 (CUSIP No. 912793 4Y 9), originally issued in the amount of $3,321 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $3,500 million to be dated May 1, 1980, and to mature October 30, 1980 (CUSIP No. 912793 5M 4).

Both series of bills will be issued for cash and in exchange for Treasury bills maturing May 1, 1980. Tenders from Federal Reserve Banks for themselves and as agents of foreign and international monetary authorities will be accepted at the weighted average prices of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents of foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington D. C. 20226, up to 1:30 p.m., Eastern Daylight Saving time, Monday, April 28, 1980. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held at the close of business on the day prior to the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering; e.g., bills with three months to maturity previously offered as six month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $500,000 or less without stated price from any one bidder will be accepted in full at the weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on May 1, 1980, in cash or other immediately available funds or in Treasury bills maturing May 1, 1980. Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

partment of the TREASURY

NEWS

HINGTON, D.C. 20220 TELEPHONE 566-2041

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M.
APRIL 23, 1980

STATEMENT OF THE HONORABLE ROBERT H. MUNDHEIM
GENERAL COUNSEL OF THE TREASURY
BEFORE THE
SENATE FOREIGN RELATIONS COMMITTEE

S. 2141--Payment of Claims Against the People's Republic of China

I am very pleased to have this opportunity to present the views of the Treasury Department on S. 2141.

The Administration does not support S. 2141 for the reasons I will elaborate below.

S. 2141 would establish new priorities in the distribution of funds to U.S. nationals under the Agreement Concerning the Settlement of Claims between the United States and the People's Republic of China of May 11, 1979. The process is already underway for the distribution to U.S. claimants of the $80.5 million which China has agreed to pay under the Agreement. The first payment of $30 million was received last October as scheduled, and the balance of $50.5 million is scheduled to be paid in five equal annual installments of $10.1 million each over the next five years.

The first section of this bill would alter the current requirement that five percent of each payment made by a foreign government, such as China, under a claims settlement agreement within the Act, be covered into Treasury's miscellaneous receipts as reimbursement for administrative expenses of the U.S. Government in connection with the administration of the claims settlement. Under the proposed amendment, the Secretary of the Treasury would cover into miscellaneous receipts the lesser of five percent or "the expenses incurred by the Commission and by the Treasury Department in the administration of this title."

Section 2 of the bill would require that the Treasury Department determine the extent to which any incorporated business enterprise claimants took a deduction for Federal income tax purposes for the same losses on which their claims before the Commission were based. Payments to such claimants would be reduced by

the full amount of such deductions. All such reductions in payment would be aggregated and distributed pro rata to non-profit organization claimants.

We believe there are several considerations which weigh against the use of actual expenses as provided for in the bill. Prior to the 1968 amendment of the Act, which provided for a five percent deduction for administrative expenses from claims settlement payments by foreign governments, the Secretary of the Treasury was required to deduct for administrative expenses first, three percent, and after 1953, five percent, from each payment made to a claimant under the Act. This change served administrative convenience. It did not alter the purpose of ensuring that the administrative cost of settling claims against foreign governments be charged not to all U.S. taxpayers as a group but rather to those U.S. nationals who directly benefit from a settlement.

Through the 30 year history of the Act, Congress has made the wise decision not to base reimbursement of the U.S. taxpayers as a whole on a determination of the exact costs of the long-term effort of a number of agencies that claims settlement requires. Instead, Congress has chosen to approximate the cost to the U.S. taxpayers from claims settlements generally, and to have reimbursement for overall U.S. Government administrative costs in claims settlements made accordingly. In contrast, reimbursement of actual expenses, as proposed here, does not take account of the way in which claims settlements of this type are implemented by the U.S. Government under the statutory scheme in the International Claims Settlement Act, nor of the distribution of functions among government agencies.

In the case of China, for example, the Commission was authorized in 1966 to hear the claims of U.S. nationals under Title V, and did so using appropriated funds over the next several years. Awards made by the Commission were then certified to the State Department, which, with Treasury, participated in negotiations towards a settlement with China, starting in the early 1970s and concluding with the initialling of the Agreement by Treasury Secretary Blumenthal in Beijing in March, 1979, and the signing of the Agreement by Commerce Secretary Kreps last spring. Last fall, as part of the payment process, the Commission certified the claims to Treasury, and Treasury received the initial Chinese payment of $30 million. Treasury's Bureau of Government Financial Operations then began to contact the individual claimants or their lawful successors, and make payment.

It would be close to impossible to determine, after the fact, the actual cost of the functions performed in this process and funded by the Congress as part of the regular functions of each agency. Quite simply, there has been no allocation at any point along the way of how much of an individual employee's time or of an office's resources were used for the China claims settlement. To require that such allocations of time and supplies be made in the future would require a substantial change in the way our agencies operate, for example, by requiring employees to maintain detailed records of how their time is spent. I should add that the cost of attempting allocation after the fact would be significant, and that making such allocations in the future would also add cost and delay to normal government functions, to the detriment of all taxpayers, including claimants.

A change to reimbursement for actual expenses of the Commission and the Treasury Department in the administration of the Act, as proposed, could leave the U.S. taxpayers paying for at least two essential functions in the China claims setlement. First, Treasury's Office of Foreign Assets Control has, since 1950, expended considerable sums in the administration of the frozen assets in the U.S. which were unblocked in January as an integral part of the settlement. Second, the State Department incurred expenses in the settlement negotiations over the last several years. Whether or not either set of expenses would be included in the determination of actual costs to be reimbursed is unclear.

In view of these considerations and the many years in which the Treasury could otherwise have been earning interest on the funds which supported the various government agencies involved, we believe that this reimbursement to Treasury's miscellaneous receipts of $4 million in the case of China would not constitute unjust enrichment of the U.S. taxpayers as a whole at the expense of the 380 claimants. Therefore, we oppose the change in treatment of administrative expenses proposed in the bill.

While the amendment proposed in Section 2 of the bill would also cause certain difficulties for the Treasury Department in carrying out its requirements, our objection to it rests primarily on policy considerations. The procedures for distribution in Section 8 of the Act were in existence as they stand now when these claims against China were heard by the Commission and when awards were made. Claimants filed their claims with the understanding that the percentage of the Commission's awards which they would eventually receive would be determined not by the claimant's tax

status, but rather by the amount of the settlement reached. Indeed, deductions for most of these losses would have to have been taken when the loss occurred, long before the Commission began accepting claims in 1968. To make major changes in the process now seems to us inequitable.

Nor does it seem fair to favor one class of claimants, non-profit organizations, over two other groups of claimants, tax-paying businesses and individuals, on the basis of their tax status. It seems inappropriate public policy to mix together two different systems with different goals, the tax system and the settlement of claims. Our progressive tax system is, and should remain, independent of the claims process.

There are several additional problems with the proposal from the tax perspective. First, paying the amount of tax deductions taken by business claimants to tax-exempt claimants will result in a loss of tax revenues. This is because payments to those business claimants now would be taxable, as payments to charities would not. Thus, all U.S. taxpayers would share the burden of this reallocation.

Second, under this proposal, a portion of the business claimants' compensation for losses determined by the Commission would be deemed to have come from tax revenues in the form of a prior deduction. While this is always true in the case of a deductible loss, normally, any subsequent compensation received is taxable to the extent the deduction created a benefit. Here, the subsequent compensation would be paid instead to tax-exempt entities.

Third, if payments to the business claimants are to be reduced, the reduction should be based on the actual amount of tax benefit which the taxpayer received from the deduction, as the taxpayer may not have benefitted to the full extent of the deduction. Indeed, under tax law, it is the amount of tax benefit, and not the amount of deduction, that would determine how much of the payments to business claimants would be taxable. A company whose facilities in China were taken in 1951 may well have had reduced income and therefore could not have deducted the full amount of the loss.

Fourth, subtractions should be made from the amount of the award, not from the amount of the pro rata payment. If a company had an award of $80,000 and tax benefit of $10,000, it should receive its pro rata share of a reduced award (40% of $70,000, $28,000) rather than its pro rata share of the full award (40% of $80,000

$32,000), reduced by the amount of tax benefit, ($10,000), which gives $22,000. To reduce the payment rather than the award penalizes those who took legitimate business deductions. Indeed, in the War Claims Act, the Commission was authorized to take the fact of deductions into account in making its awards on claims over $10,000 made by corporations, but only to the extent that tax benefit had been received by the corporation.

As a technical matter, we would need certification by the corporations of their deductions. In addition, our claims personnel would remain unable to verify the certifications absent taxpayer authorization of access to IRS records for this purpose. I might point out that the tax deduction information was supplied by only some claimants on the Commission's claims forms in the China claims program, and was, in some of those cases, incomplete. The events in question, of course, took place nearly thirty years ago.

We oppose the amendment proposed by the second section of the bill. Unlike the procedure in the War Claims Act which enabled the Commission to take tax benefit into account in determining awards, this bill would modify awards, made by the Commission eight or more years ago, on the basis of the tax status of the claimant alone. That, we believe, would be inappropriate application of the tax system. Moreover, the bill would make the modifications at the expense of all U.S. taxpayers. We cannot support such a post hoc destruction of the reasonable expectation of all claimants that their eventual compensation would be determined by the Commission in accordance with applicable law, and by the best efforts of the U.S. government in reaching a settlement.

This concludes my testimony on S. 2141. I would be happy to answer any questions you might have.

partment of the TREASURY NEWS
INGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE April 22, 1980

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $4,010 million of $9,509 million of tenders received from the public for the 2-year notes, Series R-1982, auctioned today.

The range of accepted competitive bids was as follows:

Lowest yield	11.41%
Highest yield	11.46%
Average yield	11.44%

The interest rate on the notes will be 11-3/8%. At the 11-3/8% rate, the above yields result in the following prices:

Low-yield price	99.939
High-yield price	99.852
Average-yield price	99.887

The $4,010 million of accepted tenders includes $1,009 million of noncompetitive tenders and $2,616 million of competitive tenders from private investors, including 20% of the amount of notes bid for at the high yield. It also includes $385 million of tenders at the average price from Federal Reserve Banks as agents for foreign and international monetary authorities in exchange for maturing securities.

In addition to the $4,010 million of tenders accepted in the auction process, $459 million of tenders were accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for securities maturing April 30, 1980.

M-449

11 [illegible] % TREASURY NOTES OF SERIES R-1982

DATE: 4-22-80

HIGHEST SINCE:

LAST ISSUE:
3/20/80
15 % 15.01 % YIELD

LOWEST SINCE:
12/19/79
11 [illegible] 11.43% YIELD

TODAY:
11 3/8 % 11.44 % YIELD

TREASURY NOTES OF SERIES R-1982

DISTRICT	ACCEPTED
BOSTON	$ 53,235,000
NEW YORK	2,873,285,000
PHILADELPHIA	65,215,000
CLEVELAND	123,185,000
RICHMOND	66,595,000
ATLANTA	84,400,000
CHICAGO	274,285,000
ST. LOUIS	80,220,000
MINNEAPOLIS	41,480,000
KANSAS CITY	66,235,000
DALLAS	44,300,000
SAN FRANCISCO	232,140,000
TREASURY	5,255,000
TOTAL	$4,009,830,000

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partment of the TREASURY
HINGTON, D.C. 20220 TELEPHONE 566-2041
NEWS

FOR IMMEDIATE RELEASE April 23, 1980

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $4,000 million of 52-week bills to be issued April 29, 1980, and to mature April 23, 1981, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Price	Discount Rate	Investment Rate (Equivalent Coupon-issue Yield)
High -	89.733	10.296%	11.32%
Low -	89.499	10.530%	11.60%
Average -	89.589	10.440%	11.49%

Tenders at the low price were allotted 69%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 30,140	$ 30,140
New York	5,653,690	3,535,590
Philadelphia	3,895	3,895
Cleveland	13,665	8,665
Richmond	13,140	13,115
Atlanta	70,445	20,445
Chicago	329,470	161,370
St. Louis	46,565	25,565
Minneapolis	16,045	15,545
Kansas City	11,110	11,110
Dallas	5,810	5,810
San Francisco	393,430	150,680
Treasury	18,505	18,505
TOTALS	$6,605,910	$4,000,435
Type		
Competitive	$5,136,335	$2,530,860
Noncompetitive	218,495	218,495
Subtotal, Public	$5,354,830	$2,749,355
Federal Reserve	1,072,780	1,072,780
Foreign Official Institutions	178,300	178,300
	[illegible]910	$4,000,435

52-WEEK BILL RATES

DATE: 4-23-80

HIGHEST SINCE

LAST MONTH 4/1/80 Issue
14.459%

LOWEST SINCE
9/18/79
9.893%

TODAY
10.440%

partment of the TREASURY NEWS
NGTON, D.C. 20220 TELEPHONE 566-2041

For Release Upon Delivery
Expected at 9:00 a.m. EST

STATEMENT OF
DANIEL I. HALPERIN
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
(TAX LEGISLATION)
BEFORE THE SENATE FINANCE
SUBCOMMITTEE ON TAXATION AND
DEBT MANAGEMENT
April 25, 1980

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here this morning to present the views of the Treasury Department on the miscellaneous tax bills before us today.

First let me say that the Treasury Department welcomes this opportunity to participate in meaningful hearings on the merits -- and the demerits -- of various tax proposals. The hearing process before your Subcommittee, and the similar House Ways and Means Subcommittee on Select Revenue Measures, can and must be used to advance proposals which merit our attention and also to eliminate and weed out proposals without substance. Only careful attention to substance and to policy can achieve these goals. We know this Subcommittee shares our concerns.

In the statement which follows, I have described the bills and presented our views. Our positions in summary are as follows:

S.2239. Treasury has serious reservations as to the wisdom of reinstituting qualified options.

M-451

S.1384. Treasury opposes a 10% tax credit for crops donated to charitable gleaning programs.

S.2179. Treasury opposes changing the definition of "artificial bait."

S.2396. Treasury supports tightening the eligibility rules for a "lending or finance company," and does not oppose liberalizing the types of eligible loans which can be made.

S.2367 (H.R. 6442). Treasury does not oppose exempting earnings derived prior to becoming a foreign investment company from section 1246, so long as section 1248 will apply to such earnings in an appropriate case.

S.1867. Treasury opposes increases in the deduction for use of a personal automobile in rendering services to a charity.

S.1826. Treasury opposes treating Dutch elm disease losses as casualty losses.

S.2415. Treasury opposes granting the investment credit for furniture leased to an apartment building owner and recommends that Congress act to disallow the credit for all personal use of furniture.

S.753. Treasury opposes increasing the retirement income credit.

H.R. 5973 -- Section 4. Treasury opposes this special interest change in the definition of "acquisition indebtedness."

One of the proposals requires more detailed discussion, so let me begin with that one.

S.2239

S.2239 would create an "incentive stock option," subject to tax in a manner similar to the previously available "qualified" stock option.

Present law permits employers to grant only "nonqualified" options, under which the employee recognizes taxable income, and the employer receives a corresponding deduction, equal to the bargain "spread" between the market value of stock purchased and the employee's purchase price under the option. A "qualified" option, on the other hand, permits the employee to defer paying tax until he sells the stock (assuming he holds it for three years) and then to recognize capital gain rather than compensation income. The employer is denied any deduction.

The qualified stock option was removed from the Code in 1976, primarily because Congress believed it did not provide key employees any more incentive than other forms of compensation and, in any case, because it should not be taxed more favorably than other compensation.

This rationale is correct, since employers can provide the benefits of a qualified option in another way under present law. This can be done by giving an employee a nonqualified stock option together with a cash stock appreciation right ("SAR"). For example, suppose an employee is given a nonqualified opition and an SAR at $10 per share, and the employee exercises when the stock price is $30. He pays $10 for stock worth $30 and receives $20 in cash from the company under the SAR. His taxable income is $20 on the stock plus $20 of cash (total $40), on which he pays a maximum of $20 tax (50% maximum rate). Since the cash received for the SAR covers his tax liability, the employee is in exactly the same economic position he would have been in if he had received a qualified option and no SAR. In fact, he is better off tax-wise, since his tax basis in the stock is $30 in the nonqualified case but only $10 in the qualified case.

This added benefit to the employee does cost the company a small amount. Under the SAR approach, the company is out of pocket $20, but receives $10 from the employee on the option and an income tax deduction of $40 ($20 on the SAR plus $20 on the option), worth $18.40 (46% rate), for a net cash gain of $8.40. The qualified option yields the company a $10 cash gain. This $1.60 difference on $30 stock may well be worth it, considering the benefit to the employee of receiving a $20 increase in tax basis without tax cost.

The foregoing example is summarized in the following table:

Explanation of Current Law Effect

Employee

Tax Position		Cash Position	
Excess of market value over option price	$20	Paid for Stock	($10)
		Tax Paid	($20)
Cash for SAR (Value of $30 less option price of $10)	$20	Less: Received on SAR	$20
	$40	Net	($10)
Tax-At 50% maximum tax rate	$20		

Effect: Employee has stock worth $30, with a tax basis of $30, and is out of pocket $10.

Company

Tax Position		Cash Position	
Cash Compensation	$20	Paid on SAR	($20)
Non-Cash compensation (excess of value over option price)	$20	Received for stock (option price)	$10
Total Deduction	$40	Cash flow from Tax deduction	$18.40 (46% rate)
		Net	$ 8.40

Effect: Company has $8.40 net positive cash flow.

Of course, some businesses may not be able to utilize fully the deduction for compensation paid when a nonqualified option is used. This problem exists for payments of cash wages, as well as SAR's and nonqualified

options. We question whether it is good tax policy to use this rationale to permit the employee to avoid accurate reflection of income and the proper tax on compensation received. Moreover, if loss businesses, which cannot utilize the compensation deduction, switch to qualified options, the Treasury will suffer a revenue loss. Proponents of the qualified option argue that there will be a revenue gain, since profitable businesses forego a compensation deduction, and the employee has a future capital gain rather than immediate ordinary income, in the case of a qualified option. Thus, proponents cannot consistently argue that there will be a revenue gain, while also maintaining that loss businesses are most likely to use the qualified option.

Some employers may favor the qualified option if it permits them to pay compensation without adding an expense item to the profit and loss statement. We question whether such reporting motivations outweigh good tax policy.

Accordingly, we must express serious reservations as to the wisdom of reinstituting qualified options.

S.1384

S.1384 provides a 10 percent nonrefundable tax credit to farmers who permit charities to pick crops which the farmers cannot economically harvest themselves. This type of program is typically called a "gleaning program." Although the encouragement of gleaning is certainly a laudable goal, particularly at a time when inflation results in high food costs, we think that the proposed tax credit subsidy is neither necessary nor desirable.

Under present law, the amount of a deduction for charitable contributions of appreciated inventory is limited to the taxpayer's cost or other basis for the inventory contributed (I.R.C. §170(e)(1)(A)). This rule was added to the Code by the Tax Reform Act of 1969 and was intended in part to prevent the abuse situations in which individuals in high marginal brackets and corporations could donate to charity appreciated inventory and be better off, after tax, than they would have been had they sold the property and retained the after-tax proceeds. For example, prior to the 1969 Act,

an individual in the 60 percent bracket could have contributed to a charity inventory having a basis of $50 and a fair market value of $200 and taken a charitable deduction of $200, resulting in net tax savings of $120. By contrast, if the property had been sold, the taxpayer would have realized $200, of which $150 ($200 sale price less $50 basis) would have represented taxable gain, the tax on which would have been $90. After tax, the taxpayer would have realized only $110 ($200 sale price minus $90 tax). *

Insofar as we can see, it has not been demonstrated that gleaning programs need a tax subsidy to encourage people to participate. In particular, we see no need for an extra tax credit to encourage farmers to give away crops that they now have every economic incentive to donate to a gleaning program.

Furthermore, a "gleaning" tax credit based on the value of the contributed crop would be difficult for IRS to audit and difficult for the farmer to compute, since both the quantity and price of contributed crops will have to be determined. Estimates of value are always difficult, particularly where no market exists for the item in question. Moreover, assuming that a farmer would have to reduce his deductible expenses by the amount attributable to the cost of growing the donated crop, the computation of the credit would be complicated even further.

Accordingly, we think that this is one instance when individuals can and should be left to do good on their own and the tax system should not be needlessly complicated.

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* The 1969 rule was modified in 1976 with respect to certain contributions of inventory to a charity for the care of the ill, needy, or infants by corporate taxpayers (I.R.C. §170(e)(3)). Under the 1976 provision, however, the deduction is limited in such a manner as to prevent a corporate taxpayer from being in a better after-tax situation by donating the property to a charity than by selling it. It should be noted that, under Section 170(e)(3), farming taxpayers organized in corporate form can claim a deduction for charitable contributions of gleaned crops.

S.2179

Among the items subject to the 10 percent tax on manufacturers' and importers' sales of sport fishing equipment are "artificial lures, baits, and flies." In the interpretation of this provision, the Treasury regulations state, "Thus, the term includes . . . edible materials that have been processed so as to resemble a different edible article considered more attractive to fish, such as bread crumbs treated so as to simulate salmon eggs, and pork rind cut and dyed to resemble frogs, eels, or tadpoles." Bait manufactured from gelatin or marshmallows also has been held to be taxable (Rev. Rul. 71-321). Rev. Rul. 77-302 held taxable a bait made from cheese.

The instant bill would amend the law to provide that "artificial bait" shall not include any substance which contains 85 percent or more by weight of plant or animal material which can be ingested by fish.

We do not consider the proposal a desirable amendment to the law. In the first place, it would tax artificial bait processed with less than an 85 percent content of plant or animal life. Any percentage dividing line of this type always raises a competitive problem. Making taxability or exemption of a product dependent on the relative proportion of various ingredients also makes the audit work more difficult. Our basic objection, however, is the fact that these processed edible materials are "artificial bait." They are not being sold as pork rind, cheese, marshmallows, etc., but as a specialized fish bait which is superior to a minnow, worm, or cricket.

Current law follows the logical path of taxing all artificial lures, baits, and flies, not just lures and flies. These three categories all serve a related function and all are promoted as especially designed for the catching of fish. S.2179 would differentiate artificial bait from artificial lures and flies by exempting most artificial bait. We do not believe this result would be fair to sport fishermen or the producers of items that would continue to be taxed.

S. 2396

S. 2396 would amend the provisions of the Internal Revenue Code relating to the taxation of personal holding companies in two respects. First, it would tighten the eligibility rules for the "lending or finance company" exclusion from the definition of a "personal holding company" by increasing the amount of business expenses needed to qualify for the exclusion. Second, it would liberalize the definition of a "lending or finance business" by including within such definition the business of making loans with maturities of between 60 and 144 months and the business of making loans involving open end credit transactions (revolving credit). The Treasury supports that part of S. 2396 which tightens the eligibility rules for a "lending or finance company." Furthermore, the Treasury does not oppose the provisions of S. 2396 which would liberalize the definition of a "lending or finance business" by increasing the maturity and types of eligible loans for such a business.

Under current law, a corporation is excluded from the definition of a "personal holding company" as a "lending or finance company" if: (1) 60 percent or more of its ordinary gross income is derived directly from the active and regular conduct of a "lending or finance business"; (2) its personal holding company income (computed without regard to income from its lending or finance business and by including the entire amount of certain other items) during the taxable year is not more than 20 percent of ordinary gross income; (3) the sum of its business expenses that are directly allocable to the regular and active conduct of its "lending or finance business" equals or exceeds the sum of 15 percent of so much of the ordinary gross income therefrom as does not exceed $500,000 plus 5 percent of so much of the ordinary gross income therefrom as exceeds $500,000 but not $1,000,000; and (4) loans outstanding at any time during the taxable year to a person who is a 10 percent shareholder during such taxable year do not exceed $5,000 in principal amount.

S. 2396 would remove the $1,000,000 of ordinary gross income cap on the calculation of the amount of business expenses needed to qualify as a "lending or finance company." The amount of expenses needed to qualify for the exception would be 15 percent of ordinary gross income from the lending or finance business up to

$500,000 of such income (as under current law) plus 5 percent of the excess of such ordinary gross income. As a result of this change, the overall percentage of deductions directly attributable to ordinary gross income from the lending or finance business must be equal to or greater than under current law in order for a finance company to continue to qualify for exclusion from the personal holding company provisions. The Treasury supports this part of S. 2396 as a way of further insuring that businesses qualifying for that exception continue as "active" businesses. Under current law, a business, no matter what the size of its investments or income generated by its lending activity, need only have $100,000 of business expenses to qualify as a "lending or finance company." Because the purpose of this test was to insure that such corporations "actively" be in business, this cap seems inappropriate. The test should be applied with reference to the amount of a corporation's investments or income therefrom. S. 2396 accomplishes this by requiring that the total business expenses increase as ordinary gross income increases.

S. 2396 would also liberalize the personal holding company provisions relating to the types of loans that are included in the definition of a "lending or finance business." Under current law, the term "lending or finance business" does not include the business of making loans or purchasing or discounting accounts receivable, notes, or other installment obligations, if, (at the time of the loan, purchase or discount) the remaining maturity exceeds 60 months, unless the loans, notes, or installment obligations are secured by conditional sale contracts, chattel mortgages or chattel lease agreements arising out of the sale of goods or services in the course of the borrower's or transferor's trade or business. Income from loans not included within the definition of a "lending or finance business" cannot be counted toward the 60 percent gross income test for qualification as a "lending or finance company." S. 2396 would liberalize the definition of a "lending or finance business" by increasing the maturity of loans which can be included in such a business to 144 months from the current 60 months. In addition, the business of making loans under lines of revolving credit would now be included in the definition of a "lending or finance business."

The Treasury does not oppose these provisions of S. 2396. When these provisions of the Code were last amended, a single, generalized exception was adopted to supplant the series of exceptions under prior law. In creating a single exception, Congress removed most restrictions with respect to the maturities or interest rates on loans which a qualifying corporation was able to maintain in its portfolio. It was thought that the regulation of the types of loans which could be made by consumer finance companies should be left to the states. Extending the maturities on loans that can be made by a "lending or finance" business to 144 months reflects the changes in the maturities of loans generally which consumer finance companies are now making.

Although state laws may continue to restrict the maturities and interest rates for these companies, the statute must contain some limitation to prevent small, closely held consumer finance companies from becoming mere passive investment vehicles. Increasing the maturities of loans that can be made as a part of a "lending or finance business" places greater emphasis on the revised business expense test and the requirement that the conduct of the "lending or finance business" be "active and regular," a necessary subjective judgment, in limiting the creation of mere incorporated pocketbooks.

Similarly, Treasury does not oppose allowing such closely held consumer finance companies to offer revolving credit agreements as part of their "lending or finance business." In many cases, widely held consumer finance companies are able to offer such loan agreements. So long as these businesses remain engaged in the active conduct of a "lending or finance business," it seems inappropriate to restrict the types of loans which they are able to make in pursuit of this business.

S.2367 (H.R. 6442)

Section 1246 of the Code provides that gain from the sale or exchange of stock in a foreign corporation which is a foreign investment company at any time after December 31, 1962, shall be taxed as ordinary income to the extent attributable to earnings derived after such date. Gain subject to section 1246 is taxed without the benefit of a credit for foreign taxes paid on the corporation's earnings. This treatment applies even to

gain attributable to post-1962 earnings derived while the foreign corporation was not a foreign investment company. The bill would amend section 1246 to provide that gain attributable to earnings derived before the corporation became a foreign investment company would not be subject to tax under section 1246.

The apparent intention of the bill is to tax gain attributable to earnings derived before the foreign corporation became a foreign investment company under section 1248 instead of section 1246 in the case of a foreign investment company which is also a controlled foreign corporation. Section 1248 permits gain attributable to post-1962 earnings derived by a controlled foreign corporation to be treated as a dividend, with the result that a U.S. shareholder can receive a credit for foreign taxes paid by the controlled foreign corporation on its earnings. In addition, if the foreign corporation was a less-developed country corporation prior to December 31, 1975, the gain attributable to earnings derived while the corporation was a less-developed country corporation would be taxed as a capital gain under section 1248(d)(3) (but without the benefit of a credit for foreign taxes paid on its earnings).

The Treasury Department believes that such treatment is appropriate for gain attributable to earnings derived by a controlled foreign corporation prior to the time it became a foreign investment company. We therefore do not oppose S.2367, provided that it is made clear in the accompanying Committee report that gain not covered by section 1246 by reason of the bill is covered by section 1248 in an appropriate case.

S.1867

This bill would increase the deduction allowed under present law for the use of a personal automobile in connection with rendering gratuitous services to a charitable organization.

Under present law a taxpayer may not claim a deduction for the value of services contributed to a charitable organization. However, Treasury regulations provide that unreimbursed expenditures made incident to the rendition of services may constitute a deductible

contribution. As examples, the regulations refer to out-of-pocket transportation expenses. IRS rulings provide that as to a personal automobile, only those expenses incurred for operation, repair, and maintenance which are "directly attributable" to the use of the vehicle in rendering gratuitous services are deductible. No deduction is allowed for a proportionate share of general maintenance, general repairs, depreciation or fixed costs, such as insurance or registration fees, because these costs are not directly attributable" to the use of a vehicle for charitable purposes and hence not considered to be payments "for the use of" a charitable organization.

Furthermore, in computing the cost of operating a vehicle for charitable purposes, the taxpayer may use a standard mileage rate set periodically by the IRS. The present rate is eight (8) cents per mile. Use of this standard rate, however, is not mandatory, and where a taxpayer's allowable nonreimbursed transportation expenses for charitable purposes exceed this rate, the taxpayer may deduct such actual expenses. In addition, the standard mileage rate does not include parking fees and tolls, which may be deducted as separate items by the taxpayer.

S.1867 would permit taxpayers to claim a deduction for the use of a personal automobile equal to the amount of the reimbursement which is allowed to an employee of the Government acting on official business. Effective April 24, 1980, the standard reimbursement rate for official Government business was increased from 18.5 cents per mile to 20 cents per mile. This is similar to the standard mileage rate of 18.5 cents per mile that the IRS currently allows for business use of an automobile, which takes into account the average costs of depreciation, maintenance, repairs, tires, gasoline and its related taxes, motor oil, insurance andd registration fees.

The requirement under current law that out-of-pocket expenses must be "directly attributable" to the performance of services for a charitable organization applies not only to the use of a personal automobile, but also to other property (such as airplanes or radio equipment) that is used for both personal and charitable purposes. In all cases, fixed costs, such as insurance and costs of general maintenance and repairs, as well as

depreciation, may not be deducted because they would be incurred regardless of whether the taxpayer engaged in the charitable activity. Only the marginal increase in costs should be allowed.

We oppose the proposed legislation, because we believe that the current rules provide the proper measure of the charitable deduction for the use of an automobile, or other property owned by the taxpayer primarily for personal purposes. To broaden the rules here may result in requests for similar treatment of the use of other types of personal property in charitable activities.

S.1826

S.1826 proposes an exception to the general rule concerning casualty losses. Present law provides that for an event to constitute a casualty it must constitute a sudden, unexpected and unusual occurrence. The rationale for the personal casualty loss deduction is that such a sudden loss can materially affect an individual's ability to pay taxes. Where the loss is anticipated and is not sudden, no relief through the Federal tax system is warranted because there is not reason to expect that the loss has any effect on an individual's taxpaying capacity. The Dutch Elm disease has been found by the IRS, and by the courts, to be the result of progressive deterioration due to a steadily operating cause. Far from being unexpected, an individual's loss of his elm trees to Dutch elm disease must be characterized as anticipated, once the onset of the disease is discovered. Were the provisions of section 165 extended to losses due to steadily operating causes, the deduction could be transformed from a deduction for unanticipated and sudden losses to one for depreciation, ordinary wear and tear or anticipated

obsolescence. A corollary of this would result in deductions for maintenance and repair for property subject to such wear and tear or for deductions for the replacement of such property after the expiration of the normal period of expected use. This would constitute a radical alteration of the purpose of section 165, and in the treatment of personal expenses.

An argument offered in favor of the bill is that the cost of removal, frequently mandated by local law, is a burden that bears particularly hard on the elderly. While this may be true, this is a problem caused by local law. We see no reason for redress through the Internal Revenue Code. Use of the tax system provides the smallest benefit to those with the most need. The Treasury opposes S.1826.

S.2415

S.2415 would overturn in part the decision in Aaron Rents, Inc., v. United States, 78-2 U.S.T.C. para. 9727 (N.D. Ga. 1978). The District Court held that property owned by a furniture lessor and leased to an apartment building owner was ineligible for the investment credit while property leased directly to tenants of the building was eligible for the credit. The bill would allow the investment credit in both cases.

The Treasury opposes S.2415. The Treasury also recommends that Congress should disallow the credit for furniture leased directly to tenants as well as for furniture leased to any other individuals who, if they had purchased the furniture directly, would be ineligible for the credit.

Since 1962, the law has specifically disallowed the investment credit for property used "to furnish lodging" or used "in connection with the furnishing of lodging." The rationale for this rule apparently is that residential rental accomodations were not the kinds of productive facilities that Congress intended to stimulate with the investment credit, and also that owners of

residential rental facilities fare better tax-wise than owners of other depreciable property.

The principal argument on behalf of S.2415 is that, accepting the lodging exclusion as appropriate policy for property owned by apartment building owners, it should not apply to property owned by an independent leasing company. Such property, it is said, is used in a commercial leasing venture rather than by a landlord in furnishing lodging. This assertion ignores the widely recognized fact that leasing may be used to transfer the investment credit among taxpayers. Specifically, it overlooks the treatment of the investment credit for property used by governments and tax-exempt organizations. Such organizations are ineligible for the credit on property they acquire directly, and it has been consistently the case that property "used" by such organizations is ineligible even where the property is owned by an independent leasing company and used by the ineligible entity as lessee. That same principle should apply in the case of property leased to an apartment building owner who, by reason of the lodging exclusion, would be ineligible for the investment credit on property it acquired directly.

It is also said that failure to enact S.2415 would lead to administrative difficulties by virtue of the fact that, although the District Court in Aaron Rents held that the investment credit was available for property leased to apartment building tenants, the view of the Internal Revenue Service is that the credit is unavailable in that situation. However, the Government has not decided whether to continue litigating the availability of the investment credit for property leased directly to tenants. If the Government should cease litigating the issue, the administrative complications claimed by the supporters of S.2415 would not arise.

In addition, we believe that it would be appropriate legislatively to disallow the investment credit for property owned by a leasing company but leased to individuals in their personal capacities, whether as tenants or homeowners. Congress has not seen fit to allow the investment credit for durable goods purchased by individuals for personal consumption. Yet, the decision in the Aaron Rents case could encourage individual purchasers of furniture to attempt to secure indirectly the benefit of the credit. An individual

contemplating a significant purchase of furniture might try to arrange to have a leasing company purchase the furniture and lease it to the individual on a long-term basis. The transaction might also be structured to include some sort of purchase option. The price to the individual might ultimately be lower because the furniture "lessor" claimed the investment credit. While it is not clear whether such devices would succeed, it is not difficult to imagine that individuals and their tax advisors engaged in a continuing quest for tax shelter opportunities would make an attempt sooner or later.

S.753

S.753 would amend the provisions of the credit for the elderly, expanding the base of the credit and increasing the levels of income at which the credit begins to phase out. Specifically, the "initial amount" in section 37(b)(2) would be increased from $2,500 to $3,000 in the case of a single individual or a joint return where only one spouse is eligible for the credit, from $3,750 to $4,500 in the case of a joint return where both spouses are eligible for the credit, and from $1,875 to $2,250 in the case of married individuals filing a separate return. The adjusted gross income phase-out levels would similarly be increased from $7,500 to $15,000 in the case of a single individual, from $10,000 to $17,500 in the case of a joint return, and from $5,000 to $8,750 in the case of a married individual filing a separate return. All of these amendments would be made effective for taxable years beginning after December 31, 1978.

The Treasury Department is opposed to increasing the amount of the retirement income credit without addressing the broader issue of the treatment of Social Security retirees and other retirees in general. Social Security retirees are accorded different treatment than are Civil Service and government retirees. However, these differences involve not only the extent to which retirement benefits are taxable, but also the amount of benefits of retirees relative to their payments toward retirement. The fact that some Civil Service and government workers do not seek to join the Social Security System may indicate that, for many of them, the benefits of these government retirement systems are at

least equal to those of the Social Security System when all factors -- contribution levels, benefit levels, and taxation of benefits -- are taken into account. One cannot treat the taxability of retirement benefits in a vacuum.

Moreover, as the phase-out level is raised, the retirement income credit increasingly goes to nonretired workers over 65 who receive no Social Security and are able to take a credit on their wage income. Finally, we must oppose any retroactive changes, as proposed by this bill.

H.R. 5973 -- Section 4

Section 4 of H.R. 5973 provides a limited exception to the definition of "acquisition indebtedness" for purposes of determining whether the disposition of real property by a tax-exempt organization gives rise to taxable unrelated debt-financed income. The Treasury opposes this provision of H.R. 5973.

In general, income that an exempt organization receives from investment property is taxable in the proportion that the property is financed by debt. If the property is sold, gain on the sale also is taxable in the proportion that the property is debt-financed. This proportion is determined by the highest "acquisition indebtedness" on the property for the twelve-month period preceding the date of disposition.

The circumstances under which the proposed exception would apply are limited and detailed. Basically, it would exclude a sale of real property during 1976 that had been financed before 1965, provided certain other narrow requirements are met.

We believe Congress clearly intended to tax sales of "debt-financed property." We also believe Congress intended that the test whether property was debt-financed at sale was to be judged by looking at the twelve-month period preceding the date of sale. An exempt organization planning to dispose of income producing property may extinguish the acquisition indebtedness on the property and sell it without tax only after a twelve-month waiting period.

These rules were enacted in 1969, and, after a transitional period, have applied to dispositions of all debt-financed property since 1972. Exempt organizations have had more than enough time to adjust to this provision and we have no reason to believe that they have not done so. We, therefore, consider the special retroactive exception of section 4 to be discriminatory and unwarranted.

That concludes my statement. I shall be happy to answer any questions you may have.

Department of the TREASURY NEWS
WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
Monday, April 28, 1980

Contact: Charles Arnold
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INTEREST RATE BASE FOR NEW SMALL SAVER CERTIFICATE

Secretary of the Treasury G. William Miller today advised the supervisory agencies for Federally insured depository institutions that the average 2-1/2 year Treasury yield curve rate during the five business days ending April 25 was 11.25%, rounded to the nearest 5 basis points.

This rate will be used by the agencies in determining the maximum interest payable in May on time certificates issued in denominations of less than $100,000 and maturities of two-and-a-half years.

The report of the Treasury yield curve average is announced three business days prior to the first day of each month for determination of ceilings for new variable rate savings certificates which are adjusted on the first calendar day of each month.

The commercial bank ceiling for the certificate is three-quarters of one percent below the yield on the two-and-a-half-year Treasury securities. The ceiling for thrift institutions is one-half of one percent below the yield on the two-and-a-half-year securities.

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Immediate Release
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Contact: Everard Munsey
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CHRYSLER LOAN BOARD TO MEET TUESDAY

The Chrysler Loan Guarantee Board will meet at 4:30 p.m. Tuesday, April 29 in the conference room of the Federal Reserve Board to consider the matter of issuing $1.5 billion in loan guarantees to Chrysler Corporation.

Secretary of the Treasury G. William Miller, who is Chairman of the Board, stated that the meeting had been scheduled for Tuesday to allow the staff and other parties time to complete documentation of the numerous complex proposed transactions.

The Board -- Federal Reserve Board Chairman Paul Volcker, and Comptroller General Elmer Staats in addition to Secretary Miller, as voting members -- has decided to close all its meetings during the next 30 days. In a notice to be published in the Federal Register, the Board states the meetings will be closed under the Government in the Sunshine Act because open meetings would be likely to disclose confidential commercial and financial information and because that disclosure would lead to speculation in securities and would be likely to "significantly frustrate implementation" of the Board's action.

The decision to close the meetings followed a temporary restraining order issued in the U.S. District Court for the District of Columbia on Friday enjoining any Board meeting which is not consistent with the Government in Sunshine Act. Based on legal advice, the Board maintains that it is not subject to the Sunshine Act.

As required by the court order, the meeting on Tuesday and any other meeting this week will be recorded, with the disposition of the recording dependent on future legal determinations.

partment of the TREASURY

NEWS

HINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE
April 28, 1980

Contact: George G. Ross
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TREASURY ANNOUNCES DEPRECIATION CHANGES FOR
THE DISTRIBUTIVE TRADES AND SERVICES INDUSTRIES

The Treasury Department today announced revisions in the classification, asset guideline periods, asset depreciation ranges, and annual repair allowance percentages, for three types of property: assets used in (1) wholesale and retail trade, (2) personal and professional services, and (3) marketing of petroleum and petroleum products.

The effect of the changes generally will be to shorten most asset guideline periods, except those for service asset classes (glassware, silverware, crockery and linens) which will be lengthened. In addition, the annual asset guideline repair allowance percentages will be increased.

Also, the classification of distributive trades and services automated equipment such as point of sale (POS) computer systems is clarified. In addition, outdoor advertising display structures, commonly known as billboards, and car wash buildings are enumerated as eligible property.

The changes are incorporated in Revenue Procedure 80-15, to be published in the Internal Revenue Bulletin No. 1980-17 of April 28, 1980, and are to be effective for property placed in service in taxable years ending on or after April 28, 1980 for taxpayers electing the Class Life Asset Depreciation Range System. For taxable years ending prior to April 28, 1980, distributive trades and services automated equipment such as POS computer systems described herein are properly classified in asset guideline class 00.12, 50.0, or 70.2, depending upon which class was selected by the taxpayer on its original return.

Revenue Procedure 80-15 modifies and revises related material published in Revenue Procedure 77-10 (1977-1 C.B. 548), as follows:

-- Asset Guideline Classes 13.4, Marketing of Petroleum and Petroleum Products, 50.0, Wholesale and Retail Trade, 50.1, Wholesale and Retail Trade Service Assets, 70.2, Personal and Professional Services, and 70.21, Personal and Professional Services Service Assets, are all deleted.

-- A new Asset Guideline Class (AGC) 57.0, Distributive Trades and Services is established. This class includes assets formerly included in AGC 13.4, Marketing of Petroleum and Petroleum Products (Section 1245 property), AGC 50.0, Wholesale and Retail Trade, AGC 70.2, Personal and Professional Services, and AGC 50.1 and 70.21, Service Assets.

--A new Asset Guideline Class 57.1, Distributive Trades and Services--Billboards, Service Station Buildings and Petroleum Marketing Land Improvements is established. This class includes assets formerly included in AGC 13.4, Marketing of Petroleum and Petroleum Products (Section 1250 property, including service station buildings and all depreciable land improvements), outdoor advertising display structures, whether such assets are section 1245 property or section 1250 property, and car wash buildings and related land improvements.

The asset guideline periods and the annual guideline repair allowance percentages for the property affected have been changed as follows:

Asset Guideline Class	Description of Assets Included	Asset Depreciation Range (in years)			Annual Asset Guideline Repair Allowance Percentage
		Lower Limit	Asset Guideline Period	Upper Limit	
00.12	Information Systems: Includes computers and their peripheral equipment used in administering normal business transactions and the maintenance of business records, their retrieval and analysis. Information systems are defined as: 1) Computers: A computer is an electronically activated device capable of accepting information, applying prescribed processes to the information, and supplying the results of these processes with or without human intervention. It usually consists of a central processing unit containing extensive storage, logic, arithmetic, and control capabilities. Excluded from this category are adding machines, electronic desk calculators, etc. 2) Peripheral equipment consists of the auxiliary machines that may be placed under control of the central processing unit. Non-limiting examples are: Card readers, card punches, magnetic tape feeds, high speed printers, optical character readers, tape cassettes, mass storage units, paper tape equipment, keypunches, data entry devices, teleprinters, terminals, tape drives, disc drives, disc files, disc packs, visual image projector tubes, card sorters, plotters, and collators. Peripheral equipment may be used on-line or off-line. Does not include equipment that is an integral part of other capital equipment that is included in other CLADR classes of economic activity, i.e., computers used primarily for process or production control, switching, channeling, and automating distributive trades and services such as point of sales (POS) computer systems....	5	6	7	7.5

Type of Property	Asset Guideline Classes		Asset Guideline Period			Annual Asset Guideline Repair Allowance Percentage		
	Old	New	Old	New (Years)	Effect	Old	New (Percent)	Effect
Wholesale and Retail Trade Assets	50.0	57.0	10	9	Shorter	6.5	8	Increased
Personal and Professional Services Assets	70.2	57.0	10	9	Shorter	6.5	8	Increased
Service Assets (Glassware, Silverware,	50.1	57.0	2.5	9	Longer	--1/	8	Increased
Crockery and Linens)	70.21	57.0	2.5	9	Longer	--	8	Increased
Petroleum Marketing Assets (Section 1245 Property)	13.4	57.0	16	9	Shorter	4	8	Increased
Petroleum Marketing Assets (Section 1250 Property) Land Improvements, and Service Station Buildings	13.4	57.1	16	20	Longer	4	5	Increased
Car Wash Buildings	N/A	57.1	N/A	20	N/A	N/A	5	N/A
Outdoor Advertising Display Structures (Billboards)	N/A	57.1	N/A	20	N/A	N/A	5	N/A

1/ None prescribed

The changes are the result of a continuing program of study and updating of the classes and depreciation guidelines under the Class Life Asset Depreciation Range (CLADR) System. The CLADR System classes affected by these changes are attached.

Asset Guideline Class	Description of Assets Included	Asset Depreciation Range (in years): Lower Limit	Asset Guideline Period	Upper Limit	Annual Asset Guideline Repair Allowance Percentage
57.0	**Distributive Trades and Services:** Includes assets used in wholesale and retail trade, and personal and professional services. Includes Section 1245 assets used in marketing petroleum and petroleum products...........................	7	9	11	8
57.1	**Distributive Trades and Services--Billboards, Service Station Buildings and Petroleum Marketing Land Improvements:** Includes section 1250 assets, including service station buildings and depreciable land improvements, whether section 1245 property or section 1250 property, used in the marketing of petroleum and petroleum products, but not including any of these facilities related to petroleum and natural gas trunk pipelines. Includes car wash buildings and related land improvements. Includes billboards, whether such assets are section 1245 property or section 1250 property. Excludes all other land improvements, buildings and structural components as defined in section 1.48-1(e) of the regulations.............................	16	20	24	5

Department of the TREASURY

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NEWS

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STATEMENT OF H. DAVID ROSENBLOOM
INTERNATIONAL TAX COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS

Mr. Chairman and Members of the Subcommittee. Thank you for inviting me to participate in a panel discussion today. I am grateful for this opportunity to discuss United States policy regarding tax treaties.

The questions raised in your letter inviting my testimony included: what the tax treaty policy of the United States is; what it should be; how that policy is formulated; and whether the policy should be different for developing, developed, and tax haven countries. In addition, you asked me to comment on a number of specific aspects of the process of formulating and implementing tax treaty policy.

These questions are very far-reaching.

Tax treaties represent a highly developed area of international cooperation. Few fields come to mind in which international groups have worked so consistently for so long. The model treaties produced through these efforts -- by, for example, the Organization for Economic Cooperation and Development -- constitute major achievements. Indeed, one is tempted to address your questions by referring only to the treaty materials that exist today, including the U.S. model treaties, and to review outstanding policy issues simply by comparing models and discussing their differences.

The existing models do not, however, speak to the question of what tax treaty policy might be. Because they reflect more than a half century of experience among nations, the models tend to assume answers to some fundamental questions.

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These fundamental questions are: What is the purpose of tax treaties? Are bilateral treaties the optimum means of carrying out those purposes? Is the basic approach employed by existing models the best form of bilateral agreement?

A serious review of United States tax treaty policy must begin with these questions. For this reason, the first part of my statement describes the history of international efforts to achieve "tax harmonization." This part ends with a summary of the highlights of the OECD model income tax treaty, which forms the essential basis of current United States tax treaty policy.

The second part of my testimony focuses upon the United States experience: our treaties currently in force; the present U.S. model income tax treaty and its differences from the OECD model; and the major "collateral" issues which are of significance in current negotiations. Because most of the Subcommittee's questions relate primarily to income tax treaties, I will not discuss estate and gift tax treaties. I note, however, that significant activities are under way with respect to such treaties.

In concluding, I will discuss the overall "management" of the tax treaty program: the process of designing and modifying the U.S. model; how countries are selected to negotiate with; the "bargaining" process involved in treaty negotiations; the implementation of a treaty once it enters into force; and the degree of public participation in the treaty process.

I. International Efforts To Achieve Tax Harmonization

A. The Antecedents

What we now call "direct" taxes -- taxes imposed directly on income or property -- did not come into wide-spread use until the late eighteenth and early nineteenth centuries. From the first, states imposed such taxes on a dual basis, sometimes taxing because of a relationship to the person (for example, because he was a resident of the state), sometimes taxing because of a relationship to the property or income (for example, because the property was located in the state's territory). This dual basis of taxation obviously created a potential for two states to claim a right to impose the same kind of tax on the same base. But in early times this did not generally pose a practical problem because international commerce was not highly developed and tax rates were relatively modest.

Double taxation was, however, a problem for states that were closely related by language, history, or custom, and for political subdivisions of the same state. Quite frequently in these situations, important commercial relations were threatened by direct taxes imposed on a dual basis. These situations thus gave rise to the earliest forms of "tax harmonization" laws, and interstate or international tax agreements, particularly among the Germanic states of Central Europe in the late nineteenth and early twentieth centuries.

During and shortly after World War I, double taxation became a matter of worldwide significance. Rates of direct taxation, particularly income taxation, were increasing, as was the volume of international business. In the United States, this led to the enactment, in the Revenue Act of 1918, of provisions embodying a "foreign tax credit," which allowed a deduction from the U.S. income tax of the lower of the amount paid to a foreign government as an income tax or the U.S. tax attributable to a taxpayer's foreign income. In 1920, a conference of representatives of most members of the League of Nations recommended to the League's Financial Committee that it study international double taxation and recommend means of alleviating it.

In a 1923 report commissioned by the League, four economists, from the United States, the United Kingdom, the Netherlands, and Italy, discussed the economic consequences of international double taxation; the principles governing the competence of states to impose taxes on "international" property or income; and the application of those principles in developing technical means of eliminating double taxation. For the first point -- economic consequences -- the economists used the model of a tax imposed in an "origin" or source country which supplements a pre-existing tax imposed by the country of the investor's "residence." They concluded that the principal consequence of such a tax for preexisting investments was a diminution of the value of the investment, and thus a penalty on the foreign investor. With respect to new investments, the tax was not a "burden" on the investor, since it would be discounted in making the investment and the investor could, if necessary, forego the investment altogether. Rather, the "penalty" was ultimately on the source state itself, or its consumers; the tax would raise the rate of return that an investor would demand before investing in that state. The "double" tax was, in effect, a protective tariff on the import of capital into the source state.

In regard to international competence to tax, the economists described two broad principles of modern direct taxation: "ability to pay" and "economic allegiance." The first point was simply that taxpayers should bear their share of the burden of government revenue needs in proportion to their ability to pay. The problem posed by this concept in an international context was identifying the group of persons whose "ability to pay" should be taken into account in allocating tax burdens. The economists concluded that this group should comprise those persons who owed the taxing power "economic allegiance" with respect to the property or income being taxed.

Four "elements" of economic allegiance were identified: where wealth originated; where wealth, once produced, was kept; where laws created or protected enforceable rights to wealth; and where wealth was consumed, disposed of, or enjoyed. The economists then discussed the implications of "economic allegiance" for the rights of states to tax different categories of wealth or income.

-- With respect to wealth derived from land, the state where the land was located was the dominant factor in production; the land, of course, remained in the source state; that state's laws ordinarily protected rights to land; therefore, that state, as opposed to the state of the owner's residence, had a predominant right to tax;

-- With respect to wealth derived from business property having a fixed location, and from personal property having a close relation to land, the considerations were similar to those involved in the case of land; therefore, the analysis favored the right of the source state to tax;

-- With respect to wealth derived from tangible personal property not closely tied to land, source or situs often played little part in the value of the property, and was in fact often determined arbitrarily; the state of the owner's residence, the state where the property presumably was enjoyed and which was usually also the state where rights in the property were enforced, enjoyed a predominant claim to "economic allegiance";

-- With respect to wealth derived from a category of property identified as "corporeal moveables not ordinarily capable of a fixed location" -- principally ships -- the dominant claim to tax was ascribed to the state of registry, on the ground that that was the state which enforced property rights; the state of source often could not be identified;

-- With respect to wealth derived from intangible property, considerations similar to those with respect to tangible personal property prevailed; these supported the primacy of the residence state, except in the case of real property mortgages, which were deemed akin to land;

-- With respect to earnings and salaries, the residence state had virtually sole claim to "economic allegiance."

The report discussed four methods of avoiding double tion. The first would unilaterally concede the primary t to tax to the source state. The second would concede usive taxing authority to the residence state, through ption in the state of source. The third was a portionate division" method -- dividing taxes between two es according to some predetermined formula. The fourth od was "classification and assignment" -- classifying me according to type, and assigning primary rights to tax ain types of income to one state and other types to the r.

In formulating recommendations, the economists ruled out ods which accorded primary or exclusive taxing rights to source state, largely on the ground that this would be rary to modern progressive taxation based upon an lity to pay" principle. Approaches based on pro- ionate division and classification and assignment were rejected, because the economists judged the theoretical ems involved in these approaches to be too great. Their rence was for the second method -- exemption by the e state of the income of nonresidents -- both because it led theoretical complexities and because it accorded with they viewed as economic reality: The source state d cede the right to tax when it sought investment from d. To the objection that this method would create an anced treatment of "creditor" and "debtor" countries --

the method would involve a substantial revenue sacrifice by the latter -- the economists responded with a proposal to divide revenues based upon the relative magnitude of different types of income deemed to have originated in each state. The taxpayer would not be affected.

In 1925, a Committee of Technical Experts organized by the League issued a further report on problems of double taxation. This report distinguished between "impersonal" taxes -- schedular taxes or taxes imposed on different types of income -- and "personal" taxes, that is, global taxes imposed on total income. With respect to personal taxes, the Experts recommended that the state of residence be accorded a right to impose a tax on all income. They further suggested, however, that the state of source also be assigned a right to tax income from real property, and income from agricultural, commercial, and industrial undertakings. When such dual taxation occurred, "relief" would be given in the form of a reduction of tax, calculated according to prescribed formulae, in the state of residence.

The report of the Technical Experts also addressed, for the first time, the problem of international tax evasion. On the basis of the few existing arrangements between countries, the Committee concluded that "exchange of information in taxation matters" represented the best approach to combatting such evasion.

In 1927 the Technical Experts issued the first international draft model treaties: a model income tax treaty, a model covering succession duties, and a model governing administrative assistance in the collection of taxes. These were followed in 1928 by five models issued by a General Meeting of Government Experts convened by the League to discuss the 1927 models. Three of these 1928 models were separate income tax models -- one for use between states which employed both "personal" and "impersonal" income tax systems; a second for use between states wishing to cover only "personal" tax systems; and a third covering exclusively "impersonal" tax systems.

The 1928 models provided the framework for the negotiation of a wide network of tax treaties, particularly among European nations. The models also served as a framework for the earliest United States tax treaties.

From the foregoing review it is clear that what I have referred to as the fundamental policy questions in the tax treaty area were addressed at an early date. The first

question -- what tax treaties are intended to achieve -- was considered in the first report of the economists: double taxation represents an unfair burden on existing investment, and an arbitrary barrier, destructive of international economic welfare, to the free flow of international capital, goods, and persons. Nations should seek to eliminate -- or at least alleviate -- it.

The second question concerned the choice of bilateral approaches to eliminating double taxation. The early work of the League -- particularly its sensitivity to the imbalance between "creditor" and "debtor" nations and its consideration of differences between "personal" and "impersonal" tax systems -- revealed the justification for bilateral approaches. Multilateral agreement is difficult when countries are in different economic or legal circumstances. Unilateral measures, on the other hand, are almost inevitably ineffectual. After the first international models were issued, the Hoover Administration proposed modifications of the U.S. revenue laws under which the United States would have exempted income of any foreign person except realty and business income, if the foreign country of that person's residence granted reciprocal treatment. The idea was to avoid double taxation without separate international agreements. The measure was never enacted, but it is doubtful that it would have worked. Foreign investment by U.S. persons at the time was some four times greater than investment by foreign persons in the United States. Most countries would probably not have absorbed the revenue sacrifice involved in granting the "reciprocal exemption" envisioned by the bill.

Perhaps the most significant aspect of the League's work was its ultimate choice of "classification and assignment" as the basic structure for a model bilateral agreement. This structure is today universally used in virtually all tax treaties. While the League chose "classification and assignment" because of the differences between "debtor" and "creditor" countries, the approach has been used even between countries which believe that debts and credits between them are more or less in balance. The principal impact of this method is the need it imposes to classify and assign taxation rights, in negotiations, on an item-by-item basis.

In addition, the "economic allegiance" principle articulated in the League's work is the basis for most of the substantive rules -- the actual classifications and assignments -- in modern tax treaties. Real property income

and income connected with a fixed business location are still the kinds for which a right to tax is most readily accorded to the source state. Passive investment income remains the kind which under international practice is most commonly reserved to the owner's state of residence.

B. <u>The Work of International Organizations Since 1928</u>

At the conclusion of its work, the General Meeting of Government Experts recommended that the League appoint a permanent Fiscal Committee to monitor the development of an international network of tax treaties. The most significant product of this Committee's early work was a model treaty approved in 1934, governing the attribution of profits among different components of an integrated enterprise operating in different states. This model set forth for the first time as an international standard the so-called "arm's length" principle -- that profits should be attributed to different components as if the components were separate enterprises dealing with each other at arm's length.

In 1943, the Fiscal Committee sponsored meetings in Mexico City which drafted new international models governing income taxes, estate taxes, and administrative assistance in collection. These "Mexico models" were substantially more detailed and precise than the 1928 models.

In 1946, the Fiscal Committee held another series of meetings in London; a model income tax treaty similar in structure and substance to the 1943 Mexico model, but more refined still, was drafted. Rules governing the double taxation of capital were introduced.

In 1956, acting at the urging of the international business community, the Organization for European Economic Co-operation (OEEC) -- an entity devoted to the study and resolution of interstate economic problems facing European nations -- formed a Fiscal Committee and charged it with the task of exploring the possibility of achieving a uniform multilateral treaty for the avoidance of double taxation. In its first report, in July 1958, the Fiscal Committee recognized that the task of preparing a multilateral treaty was "necessarily a long-term work"; it proposed first to issue a series of articles aiming at a "Model Bilateral Convention acceptable to all Member countries."

The Fiscal Committee proceeded to issue 30 articles in five installments, which were then collected as a model treaty in 1963. Meanwhile, in 1961, the OEEC was reconstituted as the Organization for Economic Co-operation and Development (OECD), with the addition of the United States and Canada. Other developed non-European countries, including Japan, Australia, and New Zealand, have since joined the organization.

The 1963 OECD model income tax treaty was accompanied by lengthy and elaborate commentaries which explained particular provisions. The commentaries also indicated matters not addressed in the model which might be covered in particular negotiations; the relationship of the model to the London and Mexico models, as well as the early work of the League; and the relationship of the model to prevailing practices of member states.

The OECD followed this work with the publication in 1966 of a comparable model estate tax treaty. In August 1977, the OECD issued a revised Model income tax treaty, with revised commentaries, both updated in light of the experience of member and nonmember states in working with the provisions of the 1963 model. Currently, the OECD is endeavoring to revise the 1966 estate tax model, to incorporate in that model provisions with respect to gift taxes, and to produce a new model governing reciprocal administrative assistance in tax matters.

The OECD efforts were principally directed to tax treaty negotiations between developed countries. Shortly after completion of the first OECD model, the United Nations Economic and Social Council instituted efforts to develop principles for negotiations between developed and developing countries. In 1967, the Council adopted a resolution expressing the view that tax treaties between developed and developing countries could serve to promote the flow of productive investment to the latter, and noting that, despite the widespread proliferation of treaties between developed countries, there were still very few treaties between developed and developing countries. The Council therefore requested the Secretary General to establish an *ad hoc* group of experts to study the problem of tax treaties between developed and developing countries, and to recommend guidelines for the negotiation of such treaties.

The experts came from both developed and developing countries. They are recommended by their governments, but serve in their private capacities, rather than as representatives of their governments. Since 1968, the group has met on a regular basis, and has issued eight reports on its work to the Secretary General; the reports provide a comprehensive discussion of the kind of problems raised by developed-developing country treaties. In 1974, the group issued preliminary guidelines for negotiations, which were superseded in 1979 by the issuance of a manual containing a new set of guidelines. The group intends in the near future to issue a model developed country/developing country treaty, representing a refinement of the guidelines set forth in the 1979 manual.

C. The 1977 OECD Model

The OECD model can best be described for present purposes by a brief summary of its principal categories of rules.

Taxes Covered. All income taxes of the contracting states are covered, including taxes imposed by local authorities and political subdivisions. Capital taxes are also covered, and a separate article is devoted to such taxes.

Personal Scope. Coverage extends to residents of one or both of the contracting states. It does not generally extend to cases where both states claim a right to tax on a source basis, or to cases where one state taxes on the basis of citizenship.

Source basis taxation of income from real property and permanent establishments. The OECD model retains the League principle that the source state should have the right to tax real property income. However, the model assimilates mortgage income to interest, not real property income. The model also allows a source state to tax business income fully if such income is attributable to a permanent establishment in the source state. This rule also descends from the early League work, but is now subject to exceptions which have evolved over time; moreover, there are special provisions for cases where business is conducted through an agent, providing for insulation from source basis taxation where the agent is independent and for such taxation when the agent is dependent but conducts significant business on behalf of the enterprise. The allocation rules used in these provisions

explicitly rely upon the "arm's length" principle. A special exception for international transportation income grants exclusive taxation rights to the state where the "center of effective management" of the enterprise is located.

Passive investment income. With respect to dividends and interest, the OECD model adopts the device of a limited or partial right to tax at source. Dividends may generally be taxed by the source state at a rate no higher than 15 percent; if, however, the payee is a corporation controlling more than 25 percent of the capital of the payor, the dividends are taxable at a maximum 5 percent rate. This special reduction is designed to harmonize with features of the laws of many states giving relief from double corporate level taxation for intercorporate distributions. The interest article reserves to the source state a right to tax at a rate no higher than 10 percent of the interest payment. The royalty article provides for reciprocal exemption of royalties at source.

With respect to capital gains, the model generally reserves the right to tax to the state of residence, with the exception of property closely associated with the source state -- land and permanent establishment business property. Taxation of gains from the disposition of ships and aircraft used in international operations is reserved to the state in which the centre of effective management of the enterprise is located.

Personal service income. The general rule in the OECD model is that personal service income is taxable in the state where the services are performed; but there are also a variety of special rules. With respect to "dependent" services, the state of residence has exclusive taxing rights as long as the taxpayer was present in the other state for less than half of the taxable year, and was not working under conditions such that the other state would likely be obliged to allow a deduction for his salary. "Independent" services, on the other hand, are taxable only to the extent they are connected with a "fixed base" in the source state -- a concept which parallels the permanent establishment criterion used for determining when business profits may be taxed at source. Directors' fees are taxable in the source state -- that is, the state of the paying corporation's residence. Artists' and athletes' income is invariably subject to taxation in the state where the personal services are rendered; and if the income from such services is deflected to another person, that person may be taxed in the source

state without regard to whether it has a permanent establishment or fixed base there. Pensions are taxable only in the state of residence; income from government service generally in the state paying the income; and a special provision exempts payments to students for their maintenance, education, or training.

Nonclassified income. The OECD model ultimately recognizes the primacy of the residence state in two ways. First, unclassified income, not specifically covered in the model, is taxable exclusively by that state. Second, a residual right to tax is generally accorded to the state of residence, even when the primary right to tax is granted to the source state. The residence state is required to bear the burden of eliminating double taxation for any income assigned to the source state; but it may tax the income in full if the source state does not tax it, or does not tax it at a level equal to that of the residence state.

Methods of avoiding double taxation. The OECD model provides for alternative methods of avoiding double taxation. The first, the "ordinary credit" method, is patterned on the United States foreign tax credit provisions. The residence state allows a reduction of its tax for the tax paid the other state, but is not required to allow a greater reduction than an amount bearing the same proportion to its total tax as the amount of income which the source state is allowed to tax bears to the taxpayer's total income. The second method, "exemption with progression," requires the residence state to exempt the income which the source state may tax, but permits the residence state to determine its tax on remaining income by a progressive schedule which takes account of the income taxable by the source state.

Nondiscrimination. This provision forbids states from discriminating against nationals of the other state in tax matters -- it guarantees the principle of "national treatment." Nondiscrimination provisions were common in tax treaties from an early period, but the 1963 OECD model introduced two novel forms of such provisions. The first forbids discrimination against a "permanent establishment" of a national of the other state. The second forbids discrimination against an enterprise based on the fact that its capital is owned in substantial part by nationals of the other state.

Exchange of information. The OECD model contains relatively liberal exchange of information provisions, which, however, include limitations deriving from the early work of

the League: the restriction to information in the requested state's possession, or available under its laws; and a guarantee that a requested state need not take steps contrary to its security, sovereignty, or public policy.

Mutual agreement procedure. The model provides a mechanism for the resolution of disputes; each state designates in the treaty a "competent authority" who serves as its representative for interpreting and implementing the treaty. The model provides for consultation among competent authorities, but does not require that they come to an agreement, nor does it provide any mechanism for binding them to a decision. The procedure is supplementary to procedures, including recourse to courts, which are available to a taxpayer under domestic law.

II. United States Treaty Policy

A. Existing United States Treaties

The United States presently has 30 independently negotiated income tax treaties in force. Several of these have been extended to territories of the treaty partner, and in some instances these territories have since become independent and assumed their obligations under the treaty. While a comprehensive review of U.S. treaties is not possible here, a general survey may be useful.

In part because U.S. treaties have been heavily influenced by the international models outstanding at the time of their negotiation, and in part because they have been influenced by developments in domestic law, the treaties tend to follow patterns corresponding to the periods when they were negotiated. Roughly speaking, there are four principal "periods."

The first general U.S. tax treaty -- after certain limited purpose treaties, chiefly governing the taxation of shipping profits -- was with France, signed in 1932. The principal purpose of this treaty was to mitigate the broad territorial reach of French taxation of U.S. business enterprises operating in Paris. The treaty did not deal generally with many of the subjects covered by the 1927-28 League models. It contained rules governing only income from government service; war pensions; private pensions and annuities; royalties; and business profits. The treaty contained no provisions concerning administrative cooperation or exchange of information; and none governing nondiscrimination.

Much broader was a treaty signed by the United States with Sweden in 1939, and a new treaty signed in the same year with France. The Swedish treaty was ratified in 1940, but the French treaty, which replaced the 1932 treaty entirely, was not ratified until the end of the Second World War. In these two treaties, the United States established some important principles which have remained cornerstones of U.S. tax treaty policy. The first was that tax treaties should not generally affect the taxation by the United States of its citizens and residents. The second was the emphasis given to administrative cooperation, particularly exchange of information. The United States system of collecting income taxes depends heavily upon an ability to collect information at source on payments of income, and sometimes to collect taxes at source; and our ability to obtain information concerning a person's financial activities from third parties. In the Swedish and French treaties, the United States recognized the special importance to us of obtaining access to information at source when the source was in another country.

In 1942, the United States signed a general treaty governing double taxation and administrative cooperation with Canada. This treaty differed from the 1939 treaties with France and Sweden in that it covered generally items of investment income; the French and Swedish treaties did not apply, in particular, to interest income.

These treaties -- with France, Sweden, and Canada -- represent our "early period" conventions. The 1939 treaty with France was superseded by a new treaty signed in 1967, which itself was subject to substantial revision by 1970 and 1978 protocols. The 1939 Swedish treaty was substantially revised by a 1960 protocol, but the treaty signed in 1939 is still in effect, and is our oldest. The 1942 Canadian treaty was substantially revised in 1950; but it, too, is still in effect.

The "second period" of U.S. income tax treaties was inaugurated with the 1945 treaty with the United Kingdom. This treaty generally covered items of passive investment income -- interest, royalties, dividends, capital gains -- but distinguished among particular categories of such income. Notably, it provided for exemption of interest from tax at source. The treaty was regarded as a major advance for the United States because of the United Kingdom's acceptance of broad exchange of information and administrative cooperation provisions. This treaty was substantially revised by a

protocol negotiated in 1966, and ultimately was replaced by a new treaty signed in 1975, which, with one exchange of notes and three protocols, entered into force just four days ago. The original treaty remains in force, however, with approximately fifteen jurisdictions with respect to which it was extended, with modifications, in 1958.

The first United Kingdom treaty established a model for U.S. treaties negotiated between the end of World War II and the commencement of double tax treaty work by the OEEC and, later, the OECD. During this period we negotiated treaties with most of the states of the developed world, including twelve treaties with European countries (the United Kingdom, the Netherlands, Denmark, Norway, Ireland, Greece, Switzerland, Italy, Germany, Austria, Finland, and Belgium); four with non-European developed countries (South Africa, Australia, Japan, and New Zealand); and one with a developing country (Pakistan). The treaties with Japan and Finland were superseded by new treaties in the early 1970's. The treaties with the United Kingdom and Belgium were also superseded insofar as the developed country treaty partner is concerned, but remain in force with respect to territories or former territories of those countries. And several other treaties of this period have been substantially revised by protocol.

The treaties negotiated in this general period cover the basic range of subjects in the present OECD model and the present U.S. model, although there are omissions in some of them. But the content of some of these treaties often differs from what we would seek today. Among these differences the most important concerns the typical "business profits" article. Before 1966, domestic law made the United States a "force of attraction" jurisdiction -- that is, if a foreign person was engaged in trade or business in the United States, <u>all</u> his U.S. source income was subject to tax, regardless of whether the income was attributable to the business; and we taxed <u>none</u> of that person's foreign source income even if, in an economic sense, such income was attributable to the U.S. business. In accordance with this statutory law, most of our treaties from this period provided that permanent establishments could be taxed in a source state on, and only on, income arising in the source state. When we changed our law in 1966, in addition to relieving non-"effectively connected" income from U.S. tax, we also subjected to tax "effectively connected" income having a foreign source. The existing treaties undermine the current statutory pattern of taxation, because by statute we no longer tax the non-effectively connected U.S. source income

-- even though we have the right to do so by treaty -- while the treaties preclude us from applying our domestic law to tax effectively connected income of foreign source.

Most of the treaties of this period allow a person earning real property income in the United States the right to elect annually to be taxed on a "net basis" -- i.e., at progressive rates and with deductions -- rather than at the gross (30%) rate applicable in the absence of an election. The Internal Revenue Code has permitted such an election since 1966, but that election is irrevocable unless consent to change is given by the Internal Revenue Service. Treaty provisions permitting the election to be made on an annual basis create certain tax avoidance opportunities for persons investing in U.S. real property.

Most of these treaties also concede the right of the United States to impose its "second dividend" and "second interest" taxes -- the taxes we apply to dividends and interest paid by foreign corporations doing substantial business in the United States. Most contain personal service articles different in significant detail from those we would seek today; few contain the special provisions now included in U.S. treaties governing the earnings of artists and athletes. Most have exchange of information and mutual agreement provisions that are more restrictive than we like to negotiate now. Most have imprecisely drafted provisions governing the mechanism for crediting "source country" taxes. Most contain provisions conferring benefits upon teachers, which we no longer view as appropriate. Although many of these treaties have been modified by subsequent protocols or new treaties, many outdated provisions continue in force.

This "second period" of the U.S. tax treaty program also witnessed the entering of a tax treaty relationship with smaller countries. Under the Mexico and London models, a treaty could be extended to territories of one of the parties by notice given through diplomatic channels to the other party. Our 1945 treaty with the United Kingdom contained such a "territorial extension" provision, as did several other treaties signed shortly after the World War II. In the process of seeking ratification of those treaties, however, understandings were reached between the Executive Branch and the Senate Foreign Relations Committee that no such extension would be effected without separate ratification of each extension by the Senate. In 1955, pursuant to a request by the Kingdom of the Netherlands, the United States for the first time extended a tax treaty to an overseas territory of

a treaty partner: the Netherlands Antilles. In 1957, the Belgian treaty was extended to three Belgian territories which are now Rwanda, Burundi, and Zaire. In 1958, the United Kingdom treaty was extended to 20 overseas territories of the United Kingdom.

At the same time, the United States, under the Eisenhower Administration, inaugurated a program of negotiating tax treaties which included a "tax sparing" provision. Many developing countries have, in the past and at present, relied upon special tax incentive legislation to attract foreign investment. The idea of "tax sparing" developed in the 1950's: under this concept, a developed country would agree by treaty to give a credit not only for taxes imposed by a developing country, but for taxes which would have been imposed in the absence of tax holiday legislation. This idea won widespread support among business groups interested in the double taxation problem, such as the National Foreign Trade Council and the International Chamber of Commerce.

When the first U.S. treaty with such a provision -- the treaty with Pakistan -- was submitted to the Senate for ratification, the "tax sparing" idea was greeted with hostility by the Foreign Relations Committee. The Senators emphasized the traditional view of U.S. tax treaties -- that they did not reduce or affect the tax burdens of United States persons -- and that tax sparing was obviously a departure from this principle. While the Pakistan treaty was under consideration, however, Pakistan repealed its tax incentive legislation, which mooted the treaty provision. Nevertheless, the Committee, in reporting the treaty favorably, entered a reservation to the tax sparing provision, and the treaty was approved by the Senate subject to the reservation. Three other treaties with tax sparing provisions -- with India, the United Arab Republic, and Israel -- were never reported out by the Committee.

The third group of U.S. treaties comprises those 12 treaties in force that were negotiated since 1960, but prior to publication of the U.S. model treaty in 1976. Of these, six (Luxembourg, France, the United Kingdom, Japan, Belgium, Iceland, and Finland) are with OECD countries; two (Korea, Trinidad & Tobago) are with Free World developing countries; and three (the USSR, Poland, and Romania) are with Communist countries. In addition, the United States during the this period negotiated significant protocols to some of the earlier treaties -- notably those with Germany, Sweden, and the Netherlands.

Several features distinguish these treaties from those of the prior period. With the exception of the quite unusual treaty with the USSR, these treaties tend to follow closely the structural format of the international model; but they contain special provisions, found neither in the earlier treaties nor in the OECD model, reflecting a unique approach by the United States. The most important of these provisions are those dealing with "general rules of taxation" and source of income. The general rules of taxation provide, typically, that the treaty is not to restrict any allowances, credits, or deductions permitted under domestic law; and that a contracting state is permitted to tax the income of a resident of the other contracting state only to the extent that income is from sources within the first state. The source provision includes detailed rules governing when income is deemed to arise in the source state; these rules, which typically expand to some extent upon the "source" rules set forth in the Internal Revenue Code, are designed to guarantee that the classification and assignment of substantive taxing rights will avoid double taxation in practice.

This "third period" of U.S. tax treaties saw another significant development in regard to U.S. tax relations with developing countries. Under the Kennedy and Johnson Administrations, the Treasury did not negotiate treaties with "tax sparing" provisions, because it viewed those provisions as creating an artificial bias in favor of foreign investment over domestic investment. In 1962, however, Congress adopted a statutory investment tax credit which, by its terms, was available only for investments in property placed in service in the United States. The Treasury, by treaty with developing countries, agreed to allow a similar credit for property placed in service in the developing country treaty partner, and treaties containing such provisions were signed with Thailand, Brazil, Israel, and the Philippines. This provision, too, was found unacceptable by the Foreign Relations Committee, which viewed the investment tax credit as designed to spur domestic investment and domestic employment, and which regarded it as inappropriate to extend the measure by treaty to stimulate foreign investment. Of the treaties which contained an investment tax credit feature, the Committee reported only the one with Brazil, subject to a reservation on this point; the Senate approved the treaty subject to the reservation, but the treaty never entered into force.

The fourth group of U.S. treaties are those based more firmly on the 1976 U.S. model and the revised version of that model published in 1977. Only one treaty currently in force, with Hungary, falls in this group. But there are numerous treaties currently in the process of negotiation, translation, signature, or ratification that would fall in this group as well.

A. The U.S. Model

The point of reference for all United States income tax treaty negotiations undertaken today is the U.S. model income tax treaty, which follows the OECD model in most important respects. Issued publicly for the first time in December 1976, the model was reissued, with relatively minor modifications, in May 1977. Although some U.S. negotiating positions have changed since 1977, a new version of the model has not yet been issued. We attempt to take developments into account in actual negotiations.

The most important differences between the U.S. model and that of the OECD are as follows:

Citizenship basis taxation. The OECD model applies only to states which tax globally on the basis of domicile or residence. We, of course, tax on a citizenship basis in addition to a residence basis. We regard it as appropriate to attempt to relieve double taxation which occurs when a nonresident U.S. citizen is taxed on a source basis by a treaty partner. In addition, the U.S. model contains a "saving" clause permitting taxation of U.S. citizens (including former citizens) as if no treaty were in effect. Since this rule is overbroad in certain respects, it is necessary to accompany the saving clause with specific exceptions.

Coverage of state and local taxes. Under the U.S. model, state and local income taxes are not covered, except for the nondiscrimination article. The OECD model provides for general coverage of the taxes of a political subdivision or local authority.

Corporate residence. The United States treats place of incorporation as the test of corporate residence, and the U.S. model reflects this statutory rule. Some other countries use a "managed and controlled" test. The OECD model provides that when a corporation is, under the domestic law of the contracting states, deemed a resident of each

state, its residence is determined by the place where its "effective management" is situated. The U.S. model resolves such cases on the basis of place of incorporation.

Interest exemption. The U.S. model contains a reciprocal exemption of interest at source. The OECD, in contrast, grants a right to the source state to tax at a rate not in excess of 10 percent.

Investment or holding companies. The U.S. model contains a provision not found in the OECD model, denying reductions of source basis taxation when a corporation of the other state is largely owned by nonresidents of that state and benefits in that state from special tax measures. This provision, which places the United States at the forefront of the international effort to prevent treaty abuse, requires further thought and refinement.

Elimination of double taxation. The U.S. model contains detailed provisions for relief from double taxation, and an explicit assurance of a foreign tax credit for taxes covered. Source rules are provided to permit the classification and assignment of substantive taxation rights to operate effectively. The model does not extend relief for the deemed paid credit below the first foreign subsidiary.

Beyond these fundamental differences between the models lie a wide range of other differences. Some are merely matters of style, although an effort has been made to minimize differences without substance, for the sake of facilitating negotiations. An additional list of significant points in the U.S. model would include at least the following:

Penalty taxes. The model does not cover the accumulated earnings tax and the personal holding company tax. We wish to ensure that United States persons do not evade these penalty taxes through the formation of corporations in treaty countries.

Excise taxes on insurance premiums and private foundations. The U.S. model covers these taxes, on the theory that they are, in effect, imposed in lieu of income taxes. In cases where the other country has similar taxes, we would insist upon reciprocity.

Coverage of taxes for non-discrimination and exchange of information provisions. The U.S. model covers all taxes, including state and local taxes, for purposes of the

non-discrimination article. It covers all national level taxes for purposes of the exchange of information article. The first of these provisions represents a strong United States position against discriminatory tax measures. Since there is a long tradition in the United States of state adherence to standards of non-discrimination, we attempt to secure comparable coverage by the treaty partner. With respect to exchange of information, we believe that since a treaty relationship is to be established, the broadest possible provisions for information exchange are desirable; but even if this notion is unacceptable to the treaty partner, at a minimum we wish to obtain sufficient information to permit the treaty to operate, even if the information was obtained by the treaty partner under a national level tax not generally covered by the treaty.

Trusts and partnerships. Unlike the OECD model, the U.S. model contains rules ascribing a state of residence to trusts and partnerships. These rules are intended to permit the treaty to operate in circumstances that are relatively common in United States practice.

Remittance basis. Reductions in source basis taxation are generally not justified in the face of rules in the residence state preventing taxation of the benefited income. Many countries -- particularly countries previously forming part of the Commonwealth of the United Kingdom -- provide by law that residents will not be taxed on income which is not remitted to the country. The U.S. model denies reductions in source basis taxation in such circumstances.

Construction projects. The model provides that a construction project will not be considered a permanent establishment, and thus subject to taxation at source, until it lasts for more than 24 months in the source state. This provision reflects the U.S. position as a net exporter of construction services. The comparable OECD provision is 12 months; the UN model prescribes a period of 6 months.

Net basis election for real property. The U.S. model, reflecting statutory law, permits a taxpayer to elect to be taxed on real property income on a net basis. This rule is included in the model to ensure that the other state will allow similar net basis taxation. We are prepared to delete this rule when we are satisfied, through negotiations, that the statutory law of the other state permits such taxation.

Allocation of expenses to permanent establishment. The U.S. model contains more detailed rules than the OECD model governing the allowance of deductions in the source state for expenses borne by a home office on behalf of the entire enterprise. This provision is designed to reflect United States rules governing allocations of expenses to foreign source, as opposed to domestic source, income.

Definition of business profits. The U.S. model contains a rule defining business profits, and making clear that rentals of tangible personal property and income from the licensing of films and broadcasting rights come within the definition. We seek a definition of business profits because the OECD model is ambiguous in regard to certain kinds of income. We prefer to classify film and broadcast income, and income from the leasing of tangible property, as business income, because this classification ensures taxation at source, if there is to be such taxation, on a net basis. The expenses associated with these kinds of income can be high. In contrast, the OECD model classifies these types of income as royalties, but provides for exemption at source.

Expanded definition of shipping and air transport income. The U.S. model expands the concept of income from international shipping and air transport to cover the rental of ships, aircraft, and containers used in international transport. We believe that the income from such activities is essentially similar to income from international shipping and air transport, and that the policies dictating a separate provision for the latter types of income apply equally to the former.

Direct investment dividends. The U.S. model provides for a maximum rate of 5 percent for source basis taxation of dividend income derived by a corporation owning 10 percent or more of the voting stock of the company paying the dividends. The comparable rule in the OECD model provides for a maximum 5 percent rate when the payee corporation owns 25 percent or more of the capital of the company making such payments. The U.S. preference for a 10 percent ownership test is designed to mesh with U.S. statutory law governing the deemed paid foreign tax credit.

Second withholding taxes. The U.S. model permits the United States to impose its "second withholding taxes" on dividends and interest paid by a foreign corporation deriving income from the United States. These rules are particularly important in negotiations with a country having a "branch profits" tax.

Royalties. The U.S. model provides that royalties include gains contingent on the productivity, use, or disposition of rights or property. This rule corresponds roughly with U.S. statutory law.

Capital gains on the disposition of shares in a real property holding organization. This is one respect in which our current negotiating practice deviates from the model. Under both our model and the OECD model, a source country may tax capital gains on real property. But an investor may avoid source state taxation by incorporating a holding company to own the property. This device will not insulate operating income from current taxation, but it may be effective for avoiding source taxation of capital gain on sale of the shares, which may well reflect appreciation in the value of the underlying property.

United States statutory law does not generally tax foreign investors on gains from the disposition of shares in corporations formed to hold real property. In connection with the Revenue Act of 1978, however, legislation was proposed which would have taxed gains from the disposition of shares in a company formed to hold U.S. farmland. In the 96th Congress, more far-reaching legislation has been introduced which would tax foreign investors on their gains from the disposition of shares in real property holding organizations -- entities formed to hold any U.S. real property. The legislation has had broad congressional support; and the Treasury has supported the general idea behind it.

In the face of these developments, we have modified our treaty policy and now seek a provision granting reciprocal rights to source state taxation of capital gains on the sale of shares in corporations formed for the sake of holding real property situated in that state.

Independent personal services. The U.S. model allows source basis taxation when a person is present in the source state for more than half of a taxable year. This provision, which derives from U.S. statutory concepts, is similar to the dependent personal services provisions in both the OECD and the U.S. models. It is intended to supplement the "fixed base" rule which the OECD model uses exclusively for independent services and which is sometimes difficult to administer.

Directors' fees. The U.S. model contains no separate article on this subject, reflecting the view that directors' fees should be taxed as independent personal services or dependent personal services, as the case may be. Many other countries have special statutory rules for directors' fees, because such fees are not deductible by the paying corporation. They are, in effect, considered a distribution of corporate profits.

Artists and athletes. The OECD model provides that the state where services of an artist or athlete are rendered may tax the income from such services without limit. It also provides that where income from such services is diverted to another person, the source state may tax without regard to the existence of a permanent establishment or fixed base. The U.S. model, in contrast, contains a "threshold" limiting source state taxation when an artist or athlete has not received remuneration in excess of $15,000 in the taxable year. It also limits the special rule on source state taxation of diverted income to cases where the performer has an interest in the recipient entity.

Social Security payments. The OECD model reserves to the residence state the right to tax pensions, including benefits paid from a public social security fund. The U.S. model provides for exclusive taxation of social security and other public pensions at source. Since the United States does not tax Social Security benefits, and has geared benefit levels accordingly, we seek to ensure that our benefit structure will not be impaired by taxes imposed by the other state.

Annuities, alimony, and child support. The U.S. model contains specific provisions, missing from the OECD model, to deal with these items of income. With respect to annuities and alimony, the U.S. model provides for exemption in the source state. With respect to child support, the model -- reflecting U.S. statutory law, which does not provide for taxation of such payments -- provides for exemption in both states.

Government service. The U.S. model follows the OECD model in this article, except that it contains provides a rule treating the spouse or dependent child who begins to render government service after moving abroad like the spouse who moved abroad for the purpose of rendering such service. In addition, the U.S. model provides that a citizen rendering government service will generally be treated as a resident of the sending state for all purposes under the treaty.

Students. The U.S. model provides an election for a student to be treated for tax purposes as a resident of the state in which he is studying. This provision is intended to permit the student to take advantage of statutory allowances and exemptions available only to residents. A person who makes such an election is required to pay tax on his worldwide income to the United States.

Non-discrimination. The U.S. model covers discrimination against nonresidents but provides that, in effect, nonresident aliens will not be entitled to net basis taxation in the United States. In addition, the model provides a relatively detailed rule governing the allowance of indirect expenses as deductions in the source state. In these respects the U.S. model extends principles found in the OECD model. On the other hand, the U.S. model -- unlike the OECD model -- provides no protection against discrimination by the source state for corporations not having a permanent establishment in that state.

Mutual agreement. The U.S. model provides for no time limit on the period in which a case can be presented to the competent authority, and spells out in detail some of the actions which are permissible for the competent authority to take. We think it helpful to provide as much guidance to the competent authority as possible. Many countries, which have more flexible competent authority mechanisms than the United States, do not perceive the need for such rules, which are not found in the OECD model.

Exchange of information and administrative assistance. The U.S. model provision on exchange of information is broader than that of the OECD. It expressly requires a state of which information is requested to take depositions, and engage in other specified information-gathering activities, on behalf of the requesting state. The U.S. model is intended to produce information in a form that will be useable in U.S. courts. It also contains a provision requiring the residence state to collect taxes on behalf of the source state for the purpose of ensuring that relief granted by the source state does not inure to the benefit of persons not entitled to such relief. This feature is aimed at combatting the use of nominees to secure unintended advantages under a treaty.

Territorial extension. The U.S. model contains no provision like that of the OECD model governing territorial extensions. Since territorial extensions must be

independently ratified in the United States, a territorial extension provision is of no effect and, indeed, can be misleading.

The U.S. and OECD models are, of course, blueprints for only the issues commonly faced in treaty negotiations. There are many treaty issues which do not fit within the confines of the models. These issues arise either from special features in the other country's law or in our own, or from the status of the treaty partner -- as a developing country, for example. As might be expected, these are some of the most serious and controversial issues we confront.

Imputation systems. In recent years a number of developed countries have modified their pattern of taxing corporate earnings in order to mitigate "double taxation" at the corporate and shareholder levels. This "integration" of corporate and shareholder taxation has taken a variety of forms. In some countries, distributed profits are taxed at a lower rate than undistributed profits. In others an "imputation" system is used. Imputation means that part or all of the tax charged to the corporation is allowed as a credit to the shareholder when profits are distributed as a dividend; the shareholder includes in income both the dividend and the amount of creditable tax, and claims a credit against his individual liability for the tax paid by the corporation.

Imputation itself has various manifestations. Some countries have adopted "compensating" taxes at the time of a distribution, or at the time of a distribution of previously untaxed profits, to ensure that the shareholder credit is funded by taxes paid by the corporation. Some countries allow shareholder refunds when the credit at the individual level exceeds the shareholder's tax liability. Some countries have combined split rate systems with an imputation feature. Some countries impute only a relatively small portion of corporate level taxes to the shareholder. Some countries maintain substantial residual taxes at the shareholder level. The variations on this theme are many and complex.

In most cases, however, imputation countries, by their domestic law, do not accord the shareholder tax credit to nonresidents. Nonresident shareholders are ordinarily taxed at a flat percentage of the dividend. Imputation systems thus place our investors at a disadvantage, in terms of access to capital, by comparison with investors who are

idents of the imputation country. We have sought in
aty negotiations to secure benefits for U.S. investors
mensurate with the imputation benefits granted to source
te investors. This may involve "imputation credits," or
e substitute for them, for our residents who make equity
estments in such countries. The issue gives rise to
troversy and complexity in current negotiations.

Tax sparing. A major issue, in negotiating with
eloping countries, concerns "tax sparing," the grant by
state of residence of a tax credit for taxes that would
been charged in the source state but are not because of
ial tax relief or "tax holiday" provisions. The position
developing countries is now as it was two decades ago --
t tax holidays are in their national interest and that
out tax sparing a credit country such as the United
es -- which allows the credit only for foreign taxes
ally paid -- counteracts the tax holiday legislation and
lf collects the tax "spared."

We think it inappropriate to use tax treaties to favor
ign investment over domestic investment. Moreover, given
history of this issue, we believe that a treaty
ecting a different view would be unlikely to achieve
fication.

Source basis taxation in developing countries. The OECD
J.S. models are, as indicated, designed primarily for
ties between countries where the flows of income and
al are roughly reciprocal. The limitations of source
taxation in those models produces a revenue cost for
state. However, when investment flows are more or less
rocal, the revenue sacrifices more or less offset each
. In a treaty between a developed and a developing
ry the flows are largely in one direction: income flows
the developing country to the developed country. Thus,
el which is in form reciprocal in fact can impose a
antial revenue burden on a developing country. The UN
lines, which contain a more expanded source basis of
ion, recognize the need of developing countries to
rve revenues. The shift is, however, tempered by the
conflicting need of developing countries to attract
al, an objective which is best served by limited source
taxtion.

Permanent establishment definition and business profits. The UN guidelines include an expanded definition of the permanent establishment concept.

It permits taxation by the source state if an enterprise maintains a stock of goods for delivery in that state; or if it has an agent there who regularly makes deliveries on behalf of the enterprise. It permits a limited "force of attraction" of non-attributable income at source. And it contemplates source taxation of a foreign enterprise engaged only in purchasing in the source state.

Shipping. The UN guidelines contain an optional provision allowing source state taxation of shipping activity which is more than casual, even if that activity is conducted by an enterprise managed outside that state's borders.

Investment income. With respect to dividends, interest, and royalties the UN guidelines provide for a positive rate of taxation at source, but do not fix the maximum rate; the participating developing countries believed the OECD rates -- 5 percent on direct investment dividends, 15 percent on portfolio dividends, 10 percent on interest, and zero on royalties -- were too low. With respect to capital gains, the UN guidelines reserve the right of the source state to tax shares representing a substantial participation in a company engaged in business within that state.

Personal service income. The UN guidelines treat managerial salaries as taxable in the state of a company's residence, regardless of where the managerial services are performed. They contain an option to allow source state taxation of pensions.

Other income. The UN guidelines limit residual residence state taxation to income from sources in the state of residence or from third countries; the source state is permitted to tax residual income arising, under its own laws, in that state.

The United States has long recognized that items that would likely be exempt at source in a developed country treaty may be taxable at source in a treaty with a developing country. In negotiating with developing countries we have sought primarily to shift items that such countries might prefer to tax on a gross basis into net basis taxation, since we believe net basis taxation to be both fairer and more

easonable than gross basis taxation. These points, of ourse, imply a broadened definition of "permanent stablishment" in treaties with developing countries, and is coincides with a basic thrust of the UN guidelines.

The United States has also been prepared to accept latively low thresholds for taxation of services income at urce. And we have accepted relatively high source taxation passive income in developing country treaties, focusing re on the practical need to avoid excess foreign tax edits than on the theoretical preference for residence sis taxation of such income.

As a very general matter, therefore, many of the UN idelines appear acceptable as they stand, or with latively minor revisions. We intend to draw heavily upon em in producing internal guidelines for use in negotiations th developing countries.

Foreign tax credit. In June 1979 the Internal Revenue rvice issued proposed regulations setting forth standards r determining when a payment to a foreign government nstitutes an "income tax," or a tax in lieu of an income x, creditable against U.S. tax liability under the Internal venue Code. These standards would preclude credits in the se of certain taxes which are viewed, or at least labeled, "income taxes" by the governments imposing them. The ulations have doubtless highlighted questions regarding extent to which tax treaties should, and do, guarantee eign tax credits for the taxes they cover. These stions are especially acute with respect to payments to eign governments in connection with the exploitation of ural resources. It is our present policy to accord a aty credit for covered taxes, and in some cases this lies a credit in cases where there may be doubt regarding application of the statute. In such cases of doubt we ieve the treaty credit should be limited so that it will e no effect for source state credits exceeding the tative U.S. liability with respect to income arising in t state.

State taxation using the unitary apportionment method. "arm's length" method of apportioning profits among ponents of an integrated international enterprise has been international standard since the 1930's. Within the ted States, among states, a "unitary apportionment" method still widely used. Many foreign countries have strongly cted to this method of state taxation when it is applied

to foreign controlled corporate groups. They have argued that the method results in taxing more profits than are attributable to activities conducted within a state, and that it requires a burdensome amount of information about an enterprise's worldwide operations.

Third country use. Most United States treaties allow benefits in the nature of reductions in source basis taxation to corporations organized in the treaty partner, regardless of whether the owners of the corporation are residents of, or are in any other way connected with, that country. Any treaty conceivably can, therefore, be used to effect an overall change in the incidence of United States taxation of U.S. source income, by the simple formation of a "holding company" qualifying for treaty benefits. If a person, for instance, holds equity securities subject to our 30 percent withholding tax on dividends, he can normally reduce that tax by organizing a corporation in a country with which we have a treaty reducing the rate to 15 percent.

In practice, however, this kind of "third country use" of tax treaties does not routinely arise, because it is ordinarily not cost-free to make investments through a holding company specially organized in a treaty partner. Most treaty partners of the United States will tax income received by the corporation, which ordinarily will eliminate any advantage from the reduction of the U.S. rate at source. To the extent the investor will be subject to withholding tax on payments from the corporation, or to the extent he is not able to claim complete relief in his home country for a dividend from a foreign corporation, the additional tax burden will often exceed the benefits achieved under the treaty with the United States.

This protection of the treaty process depends, however, on the existence of normal taxing provisions in the law of the treaty partner. Some of our treaty partners have special provisions granting privileges to holding companies, which result in reduced taxation of the holding company or reduced taxation on the payment of income from the treaty country to a third country. Sometimes this occurs for reasons of domestic policy, but sometimes the treaty partner has deliberately enacted provisions with the aim of attracting "offshore" business, with an eye to the revenues that can be collected from licensing fees or those taxes which are imposed; and to the service industry that can be built up around an "offshore" financing business.

In addition, treaties can be used to channel benefits to "third country" beneficiaries through the use of "conduit" companies. This practice depends upon an exemption from source basis taxation of payments from that country, and an hospitable attitude toward "offshore" business. The conduit company earns income in the United States which is subject, under the treaty, to reduced U.S. tax; the income is then siphoned off as payments deductible from the base subject to tax in the treaty partner, to the person who is the real investor.

These "treaty shopping" practices are objectionable for a number of reasons which I have previously described to this Subcommittee. The practices cause unintended revenue loss, not contemplated by the treaty "bargain." They may undermine the willingness of third countries to enter into treaty negotiations with us. And, perhaps most seriously, such practices are contrary to the spirit of international double tax treaties, and enhance opportunities for international tax evasion. Double tax treaties are, as I have mentioned, founded on the principle of allocating taxing rights based on "economic allegiance"; treaty shopping accords a revenue power to a third country, the "base country," which has little or no claim to such allegiance. In addition, since most "base countries" have local law provisions which ensure confidentiality of the identity of the ultimate investor, the conclusion is inescapable that the practices are employed to a large extent by persons evading taxes in their home country.

Within the last year we have initiated negotiations aimed at modifying three treaties which we believe present treaty shopping problems -- with Switzerland, the Netherlands Antilles, and the British Virgin Islands. Our objective in these negotiations, generally, is to secure new provisions that will eliminate or materially reduce the potential for abuse.

There are potential statutory solutions to the "treaty shopping" problem. Congress could enact a law denying benefits under income tax treaties to corporations disproportionately owned by third-country interests, or to income used to a disproportionate extent to satisfy third-country claims. Switzerland has a law like that, but it is aimed at persons using Switzerland as a base country to derive income from countries with which Switzerland has tax treaties, not at persons earning income in Switzerland. Such legislation by the United States would require careful

assessment. Statutory override of treaty bargains has a disruptive effect on our entire treaty program, if not on our foreign relations generally. Moreover, a blanket denial of benefits to corporations controlled by third country residents would undoubtedly cut too broadly since our principal difficulties stem only from a few treaties with countries which have chosen to foster an "offshore" business as a deliberate policy. Such legislation might deny benefits to arrangements having legitimate business purposes.

Coverage of possessions. A number of our negotiations have raised the question of treaty coverage of U.S. possessions. At present, none of our treaties in force applies to any of the possessions. The possessions have income tax systems which are separate from the U.S. system, although the law in force in many of them is the Internal Revenue Code as "mirrored"; and in others, the law is closely patterned on our internal tax law. We generally believe that covering the possessions is a salutary idea, because it secures the protections of a treaty for possessions residents who wish to invest or otherwise earn income abroad, and it may contribute to increased investment in the possessions. However, under present law coverage of the possessions would, as a practical matter, require the negotiation of mini-treaties, and the possessions to date have not clearly expressed interest in undertaking such an effort.

C. Management of the Treaty Program

The questions of what U.S. tax treaty policy "is" and how it is formulated ultimately depend, of course, not only upon what the models or the treaties in force provide, or what view we take in the abstract about particular issues, but also upon our methods of conducting bilateral negotiations. This raises a host of questions about the "management" of the treaty program: how we formulate or revise provisions of the U.S. model; how we determine which countries we will negotiate with; how negotiations are actually conducted; and finally, how treaties in force are administered.

Design of the U.S. model treaty. The most important decision that has been made in designing the U.S. model was to adhere as closely as possible to the OECD model. The discussion to this point indicates the basic justification for this approach: the OECD model represents an appropriate, if not perfect, theoretical basis for tax treaty negotiations; it evolved in a pragmatic way; and it offers the best

ing the maximum degree of international tax harmonization, the reduction of tax-based barriers to the free movement of goods, persons, and capital across borders, with appropriate protections against international tax evasion. In light of the widespread international acceptance of the OECD model, any other choice would, in many cases, make the achievement of treaties impossible. These considerations have prevailed in the design of the U.S. model, despite the fact that much of the language used in that model is not found in the Internal Revenue Code; that some of the concepts of the OECD model are relatively unfamiliar as well; and that, in certain respects, we believe that substantive rules in the OECD model stand in need of improvement.

Those departures we have made from the OECD model are not generally motivated by differences in economic theory or differences in our view of the practical requirements of international tax cooperation. The only major exceptions to this statement are the reciprocal interest exemption and the investment and holding company provision. The interest exemption does reflect a consistent U.S. preference for a stricter "residence" basis approach to taxing liquid international capital which moves freely from country to country; but the approach we pursue is at least implicitly conceded by the commentary to the OECD model. The investment and holding company provisions are, we believe, essential attributes of a modern bilateral treaty; but here again, the commentary acknowledges the validity of our position, and we are currently pursuing discussions at the OECD aimed at devising a common international view of treaty abuse. In general, if we believe a deviation from the OECD model is warranted based not on some peculiar circumstance of our position but because of deficiencies in the OECD approach, it is advisable to raise the question at the OECD, in an attempt to secure modification of the international model.

In general, most of the deviations we have made from the OECD model are an outgrowth of peculiar features of U.S. law. It is not necessarily true that our statutory practices in these regards are optimal, but treaties are intended to function against a backdrop of domestic law.

Finally, we are prepared to deviate from the OECD model in some instances in anticipation of changes in U.S. statutory law. Ordinarily, we would not deem it wise to change treaty policy in anticipation of statutory changes, because the changes might never occur. But we are conscious of the fact that treaties remain in effect for substantial

periods of time, and are not subject to easy revision once they enter into force. Thus, when we perceive a likelihood that legislation will be enacted, and a difficulty with existing treaty policy if it is enacted, and when we view the potential legislation and the treaty policy changes as essentially sound, we are probably wisest to anticipate the legislation and modify our negotiating policy as appropriate.

Selecting treaty partners. In cases where another country requests treaty negotiations with the United States, we are usually disposed -- subject to scheduling constraints -- to comply. Normally, we try to establish at the outset some of the groundrules under which we want negotiations to take place. For example, we forward a copy of the U.S. model in advance, sometimes accompanied by an explanation of its particular features; and we endeavor to make clear the United States position in regard to tax sparing and other incentives for foreign investment. Generally we indicate, in regard to treaties in existence, that we prefer not to negotiate exclusively for the purpose of changing a single provision. Existing treaties almost invariably stand in need of general updating, and if we are to meet we generally prefer a full review.

Insofar as United States initiated negotiations are concerned, it is best to distinguish between countries with which we already have a treaty and countries with which we seek a treaty for the first time. With respect to the former category, the most important instance where we might request negotiations would be where the treaty arrangement is producing unintended consequences. A leading example would be those treaties which give rise to extensive treaty shopping. Another case for U.S. initiated negotiations would be where significant changes in a treaty partner's law have undermined the functioning of the treaty or have altered the bargain represented by the treaty. An example would be our treaty arrangement with Italy, which has completely altered the tax system covered by the treaty in force.

A third case would be where a change in our own law has affected the operation of the treaty. Of necessity, we are slower in initiating renegotiation of treaties in this case, since changes in our law typically leave us with a host of treaties requiring revision. For example, the United States has not concertedly sought renegotiation of treaties to reflect changes brought about by the Foreign Investors Tax Act of 1966; over time, however, we have entered into negotiations because of other circumstances to revise at

least half of those treaties; in these negotiations we have undertaken the necessary process of modernization. A systematic program to revise outdated treaties is on our agenda, but it does raise serious problems with the allocation of our staff resources.

A fourth case of U.S. initiated negotiations would be where Congress by statute overrode provisions of our treaties. This has occurred only rarely; the best known example was a provision of the Foreign Investors Tax Act of 1966 which overrode our estate tax treaty with Greece, which was then renegotiated. Congress is, however, now seriously considering adopting legislation to tax foreign investors on their capital gains from sales of United States real estate, and the pending legislation by its terms would override inconsistent treaty provisions after a 5-year delay. Our hope is that, in that 5-year period, we could negotiate protocols with the various countries with which we have treaties that would be subject to the override.

With respect to countries with which we have no treaties, we make it clear that we stand ready to negotiate but ordinarily do not urge any particular country to commence negotiations. We generally make the point that a tax treaty has substantial value, because it establishes fiscal relations between the two countries and because it represents an indication to private investors of the existence of a stable climate for investment. We normally do not press particular countries to negotiate, because it has been our experience that negotiations have the best chance for success where the other country comes on its own to recognize the desirability of a treaty relationship.

The treaty bargaining process. In the process of bilateral bargaining, there are issues on which the U.S. and OECD models differ, where we are asked to make concessions in the direction of the OECD model; there are issues where we are asked to agree to a provision contrary to both models; and there are novel questions on which the models are silent.

With respect to movements in the direction of the OECD model, and movements away from both the U.S. and OECD models, there are some issues we never concede, and some where we must make a judgment based upon the overall balance of the treaty bargain. We do not concede, for example, on citizenship basis taxation; protecting provisions of U.S. law intended as penalties; non-coverage generally of state and local taxes; protection against at least some forms of

discrimination; and the U.S. statutory rule regarding corporate residence. These are issues where we perceive a strong national interest reflected in the U.S. model. While we might make a concession on at least some of these issues in certain circumstances without serious impairment of our interests, we prefer not to establish precedents clearly contrary to the model on these questions. We believe each treaty represents a separate bargain, and do not grant make concessions simply because they have been granted in other negotiations. Nevertheless, in practice it is sometimes difficult to convince another country that we have good reason for not accepting a provision that we have accepted elsewhere.

On the other hand, there are provisions in the U.S. model which are different from those of the OECD model but to which we do not ascribe great significance. For example, the rules for resolving cases of dual residence of individuals are different in our model from those proposed by the OECD. We believe our rules are better than those of the OECD, but the differences are of little practical importance and we have been prepared to adopt the OECD rules.

Between these extremes lie a wide range of issues which must be considered on a treaty-by-treaty basis. The factors we normally take into account in making the necessary judgments are the practical importance of a concession to the United States and U.S. taxpayers; the provisions of foreign law that will be operative if the concession is made; the degree to which a particular concession might be regarded as a precedent for other negotiations; and the difficulties that a particular concession might create for the ratification process.

With respect to issues not covered by existing models, our objective in seeking agreement is frequently not conformity to principle but the establishment of a principle itself. Issues regarding the imputation credit are of particular difficulty precisely because what is involved for both countries is the establishment of a new principle. Eventually, of course, whatever principle is embodied in the treaties will, in some form, find its way into the work of international organizations, since that work has always been not so much a process of formulating abstract rules as of elaborating rules established, more or less, by usage. Because of the size and economic importance of the United States, we have special responsibilities in this regard; often when a new and serious international problem arises,

like that created by the imputation systems, other countries will await the outcome of our negotiations before pursuing their own. These considerations can make bilateral negotiations over new issues very difficult.

Particular negotiations may raise special issues not covered, or not covered in sufficient detail, by the models. For example, discussions of information exchange with bank secrecy countries, and discussions of treaty shopping with tax havens, have made these negotiations unique. In these discussions we are not aiming at establishing or clarifying fiscal relations between two countries, but at solving a serious problem for the tax system. Just as we have fundamental concerns involved, the other country has concerns which it views as equally fundamental. In the best of circumstances the "trade" made in such negotiations involves a compromise which improves the situation for both sides, without requiring ultimate concessions by either.

Implementing tax treaties: the "competent authority" function. Under all tax treaties, certain powers and duties are delegated to the "competent authorities" of the contracting states. Under the U.S. model, and under our treaties in force, the term "competent authority" is the Secretary of the Treasury or his delegate; in practice, the Secretary has delegated this responsibility to the Commissioner of Internal Revenue, who in turn has delegated day-to-day responsibilities to the Assistant Commissioner (Compliance) of the Internal Revenue Service. On matters involving legal interpretations of treaties, the Assistant Commissioner (Compliance) is enjoined to seek the concurrence of the Assistant Commissioner (Technical).

The treaties spell out a number of assignments of the competent authority. The typical "mutual agreement" article states that a taxpayer may appeal to the competent authority of the state of which he is a resident or national, if he believes he is being subjected to taxation not in accordance with the treaty. The treaties authorize the competent authorities to agree to a definition of a term not defined in the treaty if an agreement on a common meaning is necessary or desirable. In addition, the treaties make the competent authorities responsible for conducting the information exchange permitted or required under the treaties. The competent authorities are authorized to communicate directly for the purpose of discharging their responsibilities. This provision is necessary to obviate the need for using diplomatic channels to effect communication between the two contracting states.

One issue with respect to the implementation of our treaties grows out of the manner in which responsibilities for conducting the treaty program and implementing treaties are divided within the Treasury Department. The Internal Revenue Service is not, in general, responsible for the conduct of treaty negotiations; that function is reserved to the Treasury's Office of Tax Policy. Of necessity, however, the Service is assigned the task of handling the "competent authority" process. The most important reason for this is that the Service is in possession of the information which another country would be likely to request pursuant to a treaty, and knows what information the United States might need. In addition, the Service has the prime responsibility for handling individual tax cases.

Public and congressional participation in the treaty negotiating process. One final problem touching on the management of the treaty program concerns the difficulty of engaging Congress and the public in the process of formulating treaty law. Treaty negotiations are conducted on a government-to-government basis, and the provisions of a treaty are not revealed publicly until after a treaty is signed. This means that outside interested parties do not have a full opportunity to comment upon, or to participate in, the development of the provisions that will be included in the treaty; the treaty is presented as a fully negotiated document when it is transmitted by the President to the Senate for advice and consent.

We have taken several steps in recent years to mitigate this problem. In 1976 we published the U.S. model, calling for public comments. The model represents our initial negotiating position; through its publication we intended to apprise the public of our objectives in treaty negotiations, and we have, in fact, received significant comments on the model. Second, we have undertaken in recent years to announce publicly at least the outset of treaty negotiations; and as of 1978, for negotiations showing promise of leading to treaties, we have held public meetings to discuss the major issues and the negotiating positions of the United States. In order to do this, we must obtain the consent of our negotiating partner; and often we are constrained, at the request of other countries, in what we may publicly discuss. Most other countries with which we have negotiated treat the negotiating process as stictly secret. For this reason we have generally declined, in our public meetings, to divulge details regarding positions taken by the other country.

Nevertheless, we do manage, through these meetings, to alert the public to most of the major issues in the negotiations, and we have frequently received useful comments and suggestions as a direct result.

Finally, the ratification process ensures full public participation after the signature of a treaty, but before it enters into force. If a provision is found objectionable to the Senate, there is ordinarily opportunity to reopen the negotiations to change the provision, although this process may involve making collateral concessions to the treaty partner.

In general, it is difficult to see a way to avoid restrictions on public participation in the treaty negotiating process. Other countries typically insist upon some degree of confidentiality for the negotiations. Moreover, fully discussing our negotiating positions, the importance each has to us, our reasons for them, and the like would tend to undermine our own position in the negotiating process. This would have the effect of prolonging negotiations generally, and would inevitably result in less favorable bargains for the United States than we might otherwise be able to obtain.

III. Conclusion

In summary, United States tax treaty policy is founded upon established international principles and practices, accommodated to reflect the special characteristics of our tax system. The essential long-range objectives of the tax treaty program are to eliminate the impediments that double taxation, or the threat of double taxation, might pose to the international flow of goods, capital, and persons, and to establish fiscal relations between the United States and other nations. In pursuing these objectives, we are sometimes forced to agree to compromise provisions that are not ideal, and to accept rules governing transactions with one country which may be different from those governing similar transactions with another. But if one considers the difficulties of making accommodations with the multitude of varying tax systems in the world today, the value of tax treaties to international economic activity clearly makes them worth these relatively small costs.

For the moment, the major short-term objectives of United States treaty policy are three-fold: First, we must update and modernize our treaties presently in force. This

process will eventually eliminate some of the irregularities of the extant pattern of treaty law. Second, we must revise those few treaties which give rise to abuse, for the sake of the integrity of the tax system and to ensure that the treaty program does not result in an unjustified loss of revenue to the United States. Finally, we need to work to expand our treaty network, particularly with developing countries. These objectives are serious and important, and they deserve a high priority; we are devoting to them as much time and effort as we can.

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Department of the TREASURY

NEWS

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

FOR IMMEDIATE RELEASE

April 28, 1980

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $3,500 million of 13-week bills and for $3,500 million of 26-week bills, both to be issued on May 1, 1980, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing July 31, 1980			:	26-week bills maturing October 30, 1980		
	Price	Discount Rate	Investment Rate 1/	:	Price	Discount Rate	Investment Rate 1/
High	97.285	10.741%	11.19%	:	94.567	10.747%	11.52%
Low	97.257	10.851%	11.31%	:	94.520	10.840%	11.63%
Average	97.273	10.788%	11.24%	:	94.545	10.790%	11.57%

Tenders at the low price for the 13-week bills were allotted 57%.
Tenders at the low price for the 26-week bills were allotted 87%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 51,065	$ 44,565	:	$ 57,360	$ 57,360
New York	5,445,795	2,837,005	:	5,246,420	2,766,770
Philadelphia	45,610	42,620	:	119,130	94,130
Cleveland	53,960	43,945	:	38,045	38,045
Richmond	41,050	35,050	:	48,945	48,445
Atlanta	57,465	54,430	:	47,525	42,180
Chicago	455,895	98,805	:	384,095	100,645
St. Louis	52,235	25,235	:	45,420	17,420
Minneapolis	19,170	11,160	:	16,845	8,845
Kansas City	43,055	37,705	:	39,830	32,160
Dallas	30,545	30,545	:	13,165	13,165
San Francisco	399,265	108,515	:	539,510	158,510
Treasury	130,895	130,895	:	122,800	122,800
TOTALS	$6,826,005	$3,500,475	:	$6,719,090	$3,500,475
Type					
Competitive	$4,716,455	$1,390,925	:	$4,885,940	$1,667,325
Noncompetitive	816,800	816,800	:	598,350	598,350
Subtotal, Public	$5,533,255	$2,207,725	:	$5,484,290	$2,265,675
Federal Reserve	933,640	933,640	:	934,000	934,000
Foreign Official Institutions	359,110	359,110	:	300,800	300,800
TOTALS	$6,826,005	$3.500,475	:	$6,719,090	$3,500,475

DATE: April 28, 1980

	13-WEEK	26-WEEK
TODAY:	10.788%	10.790%
LAST WEEK:	12.731%	11.892%
HIGHEST SINCE:		
LOWEST SINCE: 10/1/79	10.313%	
[illegible]		[illegible].662%

partment of the TREASURY NEWS
NGTON, D.C. 20220 TELEPHONE 566-2041

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FOR RELEASE AT 4:00 P.M. April 29, 1980

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $7,000 million, to be issued May 8, 1980. This offering will provide $600 million of new cash for the Treasury as the maturing bills are outstanding in the amount of $6,370 million, including $1,286 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities, and $1,586 million currently held by Federal Reserve Banks for their own account. The two series offered are as follows:

91-day bills (to maturity date) for approximately $3,500 million, representing an additional amount of bills dated February 7, 1980, and to mature August 7, 1980 (CUSIP No. 912793 4Z 6), currently outstanding in the amount of $3,231 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $3,500 million, representing an additional amount of bills dated November 13, 1979, and to mature November 6, 1980 (CUSIP No. 912793 4R 4), currently outstanding in the amount of $3,903 million, the additional and original bills to be freely interchangeable.

Both series of bills will be issued for cash and in exchange for Treasury bills maturing May 8, 1980. Tenders from Federal Reserve Banks for themselves and as agents for foreign and international monetary authorities will be accepted at the weighted average prices of accepted competitive tenders. Additional amounts of the bills may be issued to Federal Reserve Banks, as agents for foreign and international monetary authorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing bills held by them.

The bills will be issued on a discount basis under competitive and noncompetitive bidding, and at maturity their par amount will be payable without interest. Both series of bills will be issued entirely in book-entry form in a minimum amount of $10,000 and in any higher $5,000 multiple, on the records either of the Federal Reserve Banks and Branches, or of the Department of the Treasury.

Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20226, up to 1:30 p.m., Eastern Daylight Saving time, Monday, May 5, 1980. Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series) should be used to submit tenders for bills to be maintained on the book-entry records of the Department of the Treasury.

M-457

Each tender must be for a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. In the case of competitive tenders the price offered must be expressed on the basis of 100, with not more than three decimals, e.g., 99.925. Fractions may not be used.

Banking institutions and dealers who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities may submit tenders for account of customers, if the names of the customers and the amount for each customer are furnished. Others are only permitted to submit tenders for their own account. Each tender must state the amount of any net long position in the bills being offered if such position is in excess of $200 million. This information should reflect positions held at the close of business on the day prior to the auction. Such positions would include bills acquired through "when issued" trading, and futures and forward transactions as well as holdings of outstanding bills with the same maturity date as the new offering; e.g., bills with three months to maturity previously offered as six month bills. Dealers, who make primary markets in Government securities and report daily to the Federal Reserve Bank of New York their positions in and borrowings on such securities, when submitting tenders for customers, must submit a separate tender for each customer whose net long position in the bill being offered exceeds $200 million.

Payment for the full par amount of the bills applied for must accompany all tenders submitted for bills to be maintained on the book-entry records of the Department of the Treasury. A cash adjustment will be made on all accepted tenders for the difference between the par payment submitted and the actual issue price as determined in the auction.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches. A deposit of 2 percent of the par amount of the bills applied for must accompany tenders for such bills from others, unless an express guaranty of payment by an incorporated bank or trust company accompanies the tenders.

Public announcement will be made by the Department of the Treasury of the amount and price range of accepted bids. Competitive bidders will be advised of the acceptance or rejection of their tenders. The Secretary of the Treasury expressly reserves the right to accept or reject any or all tenders, in whole or in part, and the Secretary's action shall be final. Subject to these reservations, noncompetitive tenders for each issue for $500,000 or less without stated price from any one bidder will be accepted in full at the weighted average price (in three decimals) of accepted competitive bids for the respective issues.

Settlement for accepted tenders for bills to be maintained on the book-entry records of Federal Reserve Banks and Branches must be made or completed at the Federal Reserve Bank or Branch on **May 8, 1980,** in cash or other immediately available funds or in Treasury bills maturing **May 8, 1980.** Cash adjustments will be made for differences between the par value of the maturing bills accepted in exchange and the issue price of the new bills.

Under Sections 454(b) and 1221(5) of the Internal Revenue Code of 1954 the amount of discount at which these bills are sold is considered to accrue when the bills are sold, redeemed or otherwise disposed of, and the bills are excluded from consideration as capital assets. Accordingly, the owner of these bills (other than life insurance companies) must include in his or her Federal income tax return, as ordinary gain or loss, the difference between the price paid for the bills, whether on original issue or on subsequent purchase, and the amount actually received either upon sale or redemption at maturity during the taxable year for which the return is made.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76 and 27-76, and this notice, prescribe the terms of these Treasury bills and govern the conditions of their issue. Copies of the circulars and tender forms may be obtained from any Federal Reserve Bank or Branch, or from the Bureau of the Public Debt.

epartment of the TREASURY

NEWS

SHINGTON, D.C. 20220 TELEPHONE 566-2041

IMMEDIATE RELEASE
April 30, 1980

CONTACT: Everard Munsey
202/566-8191

TREASURY INTERPRETS IRANIAN ASSET CONTROL REGULATIONS

The Treasury Department today issued various interpretative and procedural amendments to the Iranian Asset Control Regulations.

The amendments make clear that the following are prohibited under the President's orders of April 9 and April 21:

* the acceptance by Americans of gratuities, grants or other support for travel to or maintenance in Iran;

* the export of technical data; and

* the sale, supply or other transfer of items for incorporation in foreign-made goods where the U.S. exporter has reasonable cause to believe the foreign-made goods are intended for export to Iran.

Remittances by U.S. citizens and permanent residents to close relatives in Iran, which were exempted from the general ban on payments to Iran, are limited by today's amendments to $1,000 a month for each payee or household.

Today's amendments also provide a general license for the export to Iran of newspapers, magazines and similar materials except those devoted principally to technical data. Also licensed were exports of household goods and personal effects of Iranians leaving the U.S. and imports of passengers' baggage by U.S. citizens, dual nationals and persons engaged in news-gathering operations, as long as the amounts exported or imported are not of commercial quantities.

The text of the amendments is attached.

# # #

IN ADVANCE OF PRINTED COPY

DEPARTMENT OF THE TREASURY

Office of Foreign Assets Control

31 CFR Part 535

Iranian Assets Control Regulations

AGENCY: Office of Foreign Assets Control, Department of the Treasury

ACTION: Final rule.

SUMMARY: The Office of Foreign Assets Control is amending the Iranian Assets Control Regulations. The purpose of the amendment is to add certain interpretative provisions, licenses and statements of licensing policy, and procedural provisions. The need for the amendment is to clarify the effect and scope of additional prohibitions added to the Regulations by amendments published on April 9 and 21, 1980. The effect of the amendment is that these additional interpretative, policy and procedural provisions will now be available in published form.

EFFECTIVE DATE: 30 APR 1980

FOR FURTHER INFORMATION CONTACT: Dennis M. O'Connell, Chief Counsel, Office of Foreign Assets Control, Department of the Treasury, Washington, D.C. 20220, (202) 376-0236.

SUPPLEMENTARY INFORMATION: Since the Regulations involve a foreign affairs function, the provisions of the Administrative Procedure Act, 5 U.S.C. 553, requiring notice of proposed rule making, opportunity for public participation and delay in effective date are inapplicable.

On April 9, 1980, the Office published §§535.206 and 535.207 imposing additional financial and trade sanctions

on Iran. (45 FR 24432.) New §535.429 published today interprets the trade prohibition in §535.207(a)(1) as including the exportation of technical data in any form. New §535.430 further interprets the prohibition as including the sale, supply or other transfer of items, commodities or products for incorporation in foreign-manufactured goods where the U.S. exporter has reasonable cause to believe that the foreign-manufactured goods are intended for export to Iran.

New §535.575 is a general license for the exportation to Iran of newspapers, magazines, journals, newsletters, books, films, phonograph records, photographs, microfilms, microfiche, tapes and similar material. The general license does not apply to materials which are principally devoted to the dissemination of technical data.

New §535.577 is a general license for the exportation to Iran of household goods and personal effects of Iranian individuals departing the United States. The general license does not apply to goods in commercial quantities.

New §535.603 sets forth the procedure to be followed in giving notice to the Office pursuant to §§535.206(b) and 535.207(b) which require notice by the U.S. parent firm 10 days prior to entry of its foreign affiliate into any transaction covered by §§535.206(a) and 535.207(a).

On April 21, 1980, the Office published additional restrictions with respect to Iran, including prohibitions on remittances to any person in Iran, travel restrictions,

and a prohibition on imports from Iran and of Iranian-origin goods. (45 FR 26940.)

New §535.426 clarifies the prohibition on remittances. Remittances to third countries are not prohibited unless the remitter knows or has reasonable cause to believe that the remitted funds are being transferred to the country of Iran. The new section also clarifies the liability of remitting banks under §535.206(a)(4). It makes clear that U.S. banks are not responsible for policing the multitude of items processed electronically but must not complete transactions where current and actual knowledge provides information that gives reasonable cause to believe that the remittance is prohiibited.

New §535.427 clarifies that the prohibition in §535.206(a)(4) includes payments of dividends, interest, and other periodic payments.

New §535.428 explains that acceptance of free sponsorship or support for travel to or travel and maintenance in Iran is a "transaction" or "transfer" prohibited by the travel restrictions of §535.209(a).

New §535.431 clarifies that the prohibition on importation of Iranian-origin merchandise does not apply to such merchandise where the bill of lading is dated on or before April 17, 1980, indicating that the merchandise left Iran on or before that date.

New §535.528 authorizes certain transactions by persons subject to the jurisdiction of the United States in connection

of an application for, or

certain other proceedings involving, an Iranian patent, trademark, or copyright.

New §535.550 sets forth the licensing policy on imports of publications and similar items from Iran.

New §§535.562(c) and 535.578 are general licenses authorizing the importation of passengers' baggage by U.S. citizens, dual nationals, persons engaged in news gathering operations and certain other persons.

The general license in §535.563 for family remittances is being amended by the addition of paragraph (d) placing a monthly limit of $1000 on such remittances per payee or per household.

New §535.576 contains a general license authorizing payment by persons subject to the jurisdiction of the United States of existing non-dollar letters of credit in favor of Iranian entities or persons in Iran where letters of credit are denominated in foreign currencies.

1. §535.426 is added as follows:

§535.426 Remittances involving persons in Iran.

(a) Remittances to countries other than Iran are not prohibited by §535.206(a)(4) unless the remitter knows or has reasonable cause to believe that the funds are being transferred directly or indirectly to Iran.

(b) Subject to the requirement of paragraph (c) of this section, liability of a U.S. bank under §535.206(a)(4) in connection with a payment made on the order of a party other than the bank is limited to the following transactions:

(1) Payment from an account held by the bank for a person located in Iran;

(2) Payment from any other account where the bank has actual and current knowledge of facts that give reasonable cause to believe that the payment is being made in violation of §535.206(a)(4).

(c) U.S. banks are required to disseminate information about the prohibitions contained in §535.206(a)(4) and the provisions of this section to all officers and employees.

2. §535.427 is added as follows:

§535.427 Dividends, interest, and other periodic payments to Iran.

The prohibition of transfers to persons in Iran contained in §535.206(a)(4) applies to all payments and transfers, including payment or transfer of dividend checks, interest payments and other periodic payments.

3. §535.428 is added as follows:

§535.428 Sponsored travel and maintenance of U.S. nationals in Iran.

The receipt or acceptance by any person who is a U.S. citizen or U.S. permanent resident alien of any gratuity, grant, or support in the form of meals, lodging, payments of travel or maintenance expenses, or otherwise, in connection with travel to or travel and maintenance within Iran constitutes a transaction or transfer within the meaning of the prohibition set forth in §535.209(a).

4. §535.429 is added as follows:

§535.429 Exportation of technical data prohibited.

(a) The prohibition in §535.207(a)(1) includes transfers of information, in eye-readable or machine-readable form, intended for use, directly or indirectly, in the design, production, manufacture, reconstruction, servicing, operation or use of any product.

(b) The prohibition on the exportation of technical data extends not only to unpublished technical information that is not available to the public, but also to published technical data such as operating, repair or service manuals for automotive or industrial equipment that are available through commercial sources such as book distributors.

5. §535.430 is added as follows:

§535.430 U.S. components of foreign-made goods.

The prohibitions in §535.207(a)(1) apply to the sale, supply or other transfer after the effective date of §535.207 of items, commodities or products for incorporation in foreign-manufactured goods where the person subject to the jurisdiction of the United States has reasonable cause to believe that those goods are intended for export to Iran.

6. §535.431 is added as follows:

§535.431 Goods in transit.

Shipments of Iranian origin merchandise covered by a bill of lading dated on or before April 17, 1980 are not within the prohibition in §535.204.

7. §535.528 is added as follows:

§535.528 <u>Certain transactions with respect to Iranian patents, trademarks and copyrights authorized</u>.

(a) The following transactions by any person subject to the jurisdiction of the United States are authorized:

(1) The filing and prosecution of any application for an Iranian patent, trademark or copyright, or for the renewal thereof;

(2) The receipt of any Iranian patent, trademark or copyright;

(3) The filing and prosecution of opposition or infringement proceedings with respect to any Iranian patent, trademark, or copyright, and the prosecution of a defense to any such proceedings;

(4) The payment of fees currently due to the government of Iran, either directly or through an attorney or representative, in connection with any of the transactions authorized by subparagraphs (a) (1), (2) and (3) of this paragraph or for the maintenance of any Iranian patent, trademark or copyright; and

(5) The payment of reasonable and customary fees currently due to attorneys or representatives in Iran incurred in connection with any of the transactions authorized by subparagraphs (a) (1), (2), (3) or (4) of this paragraph.

(b) Payments effected pursuant to the terms of paragraph (a)(4) and (5) of this section may not be made from any blocked account.

(c) As used in this section the term "Iranian patent, trademark, or copyright" shall mean any patent, petty patent, design patent, trademark or copyright issued by Iran.

8. §535.550 is added as follows:

§535.550 Publications, films, etc. from Iran.

(a) Specific licenses are issued as appropriate for importations of publications, films, posters, phonograph records, photographs, microfilms, microfiche and tapes originating in Iran. All payments due the suppliers will be required to be made into accounts in domestic banks subject to the provisions of §535.201 or §535.206(a)(4). Such an account shall be established in the name of the seller and the licensee shall report such information concerning the importation and the account established in the name of the seller as the Office of Foreign Assets Control may require as a conditic of the license.

(b) Such importations of publications, films, etc. are also licensed appropriate when the Office of Foreign Assets Control is satisfied that they are bona fide gifts to the importer and that there is not and has not been any direct or indirect financial or commercial benefit to an Iranian entity or any person in Iran from the importations.

9. §535.562 is amended by the addition of new paragraph (c) as follows:

§535.562 News material.

*　　*　　*　　*　　*

(c) Accompanied baggage of journalists and news correspondents. All transactions incident to the importation into the United States of accompanied baggage of a journalist or other person referred to in paragraph (b) of this section are aurthorized, provided that such baggage does not contain goods in commercial quantities.

10. §535.563 is amended by the addition of new paragraphs (d) and (e) as follows:

§535.563 Family remittances to Iran.

* * * *

(d) Remittances authorized by this section are limited to $1000 per month to any one payee or to any one household.

(e) Any remittance exceeding the amount specified in paragraph (d) of this section would require a specific license.

11. §535.575 is added as follows:

§535.575 Exports of newspapers, magazines, films, etc to Iran.

All transactions not inconsistent with §535.419 and ordinarily incident to the export to Iran of newspapers, magazines, journals, newsletters, books, films, phonograph records, photographs, microfilms, microfiche, tapes or similar materials are authorized, except such materials which are principally devoted to the dissemination of technical data.

12. §535.576 is added as follows:

§535.576 Payment of non-dollar letters of credit to Iran.

Notwithstanding the prohibitions of §§535.201 and 535.206(a)(4), payment of existing non-dollar letters of credit in favor of Iranian entities or any person in Iran by any foreign branch or subsidiary of a U.S. firm is authorized, provided that the credit was opened prior to the respective effective date.

13. §535.577 is added as follows:

§535.577 <u>Household goods and personal effects</u>.

All transactions incident to the exportation to Iran of household goods and personal effects of an Iranian individual departing the United States are authorized, provided that no goods in commercial quantities may be exported under this general license.

14. §535.578 is added as follows:

§535.578 Passengers' baggage and personal effects.

(a) All transactions incident to the importation into the United States of baggage, household goods and personal effects of the following persons are authorized, provided that such importation does not include goods in commercial quantities:

(1) United States citizens and U.S. resident aliens who departed Iran on or before April 24, 1980;

(2) Third country nationals; and

(3) Dual nationals of the United States and Iran.

(b) All transactions incident to the importation into the United States of baggage, household goods and personal effects of an Iranian national who enters the United States on a visa issued by the Department of State are authorized, provided that such importation does not include goods in commercial quantities.

(c) All transactions incident to the importation into the United States of baggage and personal effects of a crew member of vessels or aircraft in the United States on temporary sojourn are authorized, provided that such importation does not include goods in commercial quantities and any such articles are intended for export from the United States with the crew member upon his departure.

15. §535.603 is added as follows:

§535.603 Report of Proposed Subsidiary Transaction with Iran.

(a) A U.S. company required by §535.206(b) or §535.207(b) to submit a report to the Office of Foreign Assets Control regarding a proposed transaction with Iran by a subsidiary shall submit a letter containing the following information.

(1) Name of the foreign subsidiary involved

(2) Location

(3) Description of the merchandise

(4) Value

(5) Ultimate Iranian consignee

(6) Identity of any intermediary firm(s)

(7) End-use

(8) Payment terms

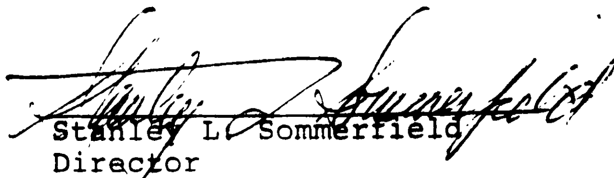
(b) The report shall be addressed as follows:

Ms. Susan Swinehart
Chief of Licensing
Office of Foreign Assets Control
Treasury Department
Washington, D.C. 20220

Att: Section 535.603 Report--
EXPEDITE

(c) The report must be submitted in sufficient time to reach the Office of Foreign Assets Control 10 days before any subsidiary enters into any transaction covered by §535.206 or §535.207.

Dated: 30 APR 1980



Stanley L. Sommerfield
Director

Approved:
Richard J. Davis
Assistant Secretary

[Authority: Sec. 201-207, 91 Stat. 1626, 50 U.S.C. 1701-1706; E.O. 12170, 44 FR 65729, E.O. No. 12205, 45 FR 24099; E.O. No. 12211, 45 FR 26685.]

Filed: April 30, 1980

Publication date: May 2, 1980

partment of the TREASURY

NEWS

IINGTON, D.C. 20220 TELEPHONE 566-2041

EMBARGOED FOR RELEASE UNTIL DELIVERY
Expected at 9:30 a.m.

STATEMENT OF
THE HONORABLE
G. WILLIAM MILLER
SECRETARY OF THE TREASURY
BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
APRIL 30, 1980

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the President's proposal for withholding on interest and dividends.

Underreporting of interest and dividend income is no longer a problem that we can afford to ignore. In 1979 taxpayers underreported interest and dividend income by about $16 billion and thereby underpaid their taxes by approximately $3.6 billion. Other taxpayers bear the cost of these lost revenues by paying a larger share of the tax burden.

Balancing the budget is a national priority in the fight against inflation. As we ask the American people to accept fiscal discipline, with cuts in spending for important economic and social programs, we must at the same time take positive action to avoid needless loss to the Treasury of billions of dollars due under present tax laws.

Withholding is not a new tax.

To combat this needless loss to the Treasury, the President has proposed a system of withholding on interest and dividends similar to the current system of withholding on the wages of our nation's workforce, a system that has served us well since 1943. Withholding benefits not only

M-459

the government, but also benefits taxpayers by providing them with a gradual and systematic way to pay their taxes.

Let me emphasize that withholding is not a new tax. As with wage withholding, withholding on interest and dividends does not increase anyone's tax liability; it only changes the method by which the taxes are paid. The purposes of the withholding program are simple -- to collect taxes due on interest and dividend income and to ensure that all taxpayers report the full amount of their income and pay their fair share of taxes.

It has been strongly argued in recent years that the tax system relies too heavily on taxing savings and investment. This issue is being examined closely. But it cannot plausibly be argued that the way to lighten the tax burden on savings is to facilitate noncompliance with current tax laws.

Compliance is a current problem.

Overall our system of income taxation works very smoothly. It is administered with honesty and integrity and with very low administrative and enforcement costs.

Nevertheless, a recent Internal Revenue Service report on income unreported by individuals clearly indicates that substantial numbers of individuals do not pay the full amount of tax that they owe because they fail to report the full amount of their investment income. The report presents the findings of a year-long study by an Internal Revenue Service task force appointed by the Commissioner to review all available data for the purpose of developing the best possible estimates of unreported income. The report determined that the 1976 gap between taxable interest payments received by individual taxpayers and taxable interest payments reported on individual income tax returns ranges from $5.4 billion to $9.4 billion. The 1976 gap between taxable dividend payments received by individuals and those reported on tax returns is estimated to range from $2.1 billion to $4.7 billion. While individuals are estimated to underreport wage income by only 2 to 3 percent, they omit 9 to 16 percent of interest and dividend income, a rate of noncompliance that is at least 300 percent greater.

As a result of continued substantial noncompliance in the reporting of investment income, about $3.6 billion in

taxes that were lawfully due were not collected in 1979. It is estimated that in calendar year 1981 this tax loss will increase to approximately $3.9 billion.

Underreporting of investment income jeopardizes the very cornerstone of our tax system -- self-assessment. The Internal Revenue Service now audits only about 2 percent of individual returns filed each year. Withholding provides a logical means to attain high compliance with low audit coverage.

Information reporting alone is not enough.

Some have suggested that the existing system of information reporting -- or an expanded system -- would solve the reporting problem if only the Internal Revenue Service would do its job. In 1962 the Senate rejected the withholding approach adopted by the House on the ground that improved compliance should first be sought by expanding the information reporting requirements. This has been done.

The intervening eighteen years have provided an ample test of information reporting alone as a compliance measure. The results of the recent Internal Revenue Service report on unreported income clearly indicate that, even with the additional reporting requirements enacted in the Revenue Act of 1962, taxpayers still fail to report and pay tax on significant amounts of taxable dividends and interest for which information reports are filed. Certainly the time has come to reassess how tax should be collected on interest and dividend income and why information reporting alone is not sufficient.

The Internal Revenue Service now matches at least 72 percent of the information documents that it receives on interest and dividends and uncovers several million discrepancies. Much of the nonreporting is apparently due to inadvertence, forgetfulness and failure to keep records, particularly by taxpayers who receive relatively small amounts of dividend and interest income. Other nonreporting is due to nonfilers who owe some tax but who are difficult to trace. Because of the small amount of revenue to be gained from any one taxpayer, the cost of following up the millions of discrepancies is demonstrably uneconomical. Even extensive pursuit of taxpayers would not achieve full collection of unpaid taxes. There would be many unfruitful investigations where taxpayers cannot be reached by telephone or traced if they have moved. Even after the taxes have been assessed, it would be impossible or uneconomical to collect them.

The present situation, then, is that the Internal Revenue Service uncovers many more leads through its matching program than it pays to pursue. To follow up on all of these leads would require millions of telephone calls, letters and visits, and audit efforts concentrated on individuals. This would inevitably be regarded as harassment of "little people" and would require shifts in staffing that would prevent the Service from directing its limited resources towards auditing compliance areas that are not susceptible to withholding.

Withholding is now necessary.

How will withholding help? A substantial portion of the taxes that now go unpaid will be collected without costly audit procedures. Not only will withholding automatically collect much of the tax owed, but people will have more incentive to pay the remainder of their taxes due if part of their taxes have already been paid. The Service will be able to channel its audit resources to those areas where they are most needed and that best serve the public -- the complicated returns of corporations, partnerships and sophisticated high-bracket individuals.

The Administration expects that withholding will also increase the accuracy of information being submitted to the Internal Revenue Service, thereby reducing the cost of reconciling discrepancies on returns. Since taxpayers will receive credit for withheld tax, they will have a positive incentive to supply payors with better information. Likewise, taxpayers will be less likely to lose or forget about their dividend and interest reports if these reports must be attached to the return in order to claim the credit. Information reporting alone provides no such incentives. The Internal Revenue Service estimates that more than 11 percent of information returns required to be filed by payors (Form 1099's) have inaccurate or missing Social Security numbers (taxpayer identification numbers), making accurate matching of documents in such cases extraordinarily expensive. By comparison, the rate of error on information returns for wages (Form W-2), where the taxpayer is entitled to a credit for the taxes paid, is estimated to be about 3 percent.

Experience with wage withholding has proven that withholding is the most effective means of ensuring compliance in the reporting of income. Wage-earners now pay their taxes on a regular basis through withholding. Information

reporting and the system of estimated tax payments simply have not been as effective. There is no reason why recipients of dividends and interest should not be held to the same standards of withholding and compliance that are set for wage-earners.

Summary of the proposal

Under the President's proposal, 15 percent will be withheld on taxable dividends and interest paid to individuals with respect to deposits and securities of a type generally offered to the public. Most dividend and interest income is currently subject to information reporting; the proposal builds primarily upon the system that is now in place. The proposal also will extend withholding to instruments with respect to which reporting is not currently required, including obligations of the U.S. government, such as Treasury bills, as well as corporate coupon bonds and government agency issues.

Payments to corporations (including corporate nominees and corporate trustees) and noncorporate securities dealers will be exempt from withholding. This exemption simplifies the withholding system administratively. Moreover, there are other safeguards to prevent noncompliance by these entities, such as normally higher audit coverage by the Internal Revenue Service. Exempt recipients will include banks and thrift institutions, regulated investment companies, collective investment funds managed by banks, money market funds and the like. All of these entities will, however, be required to withhold upon the payment of dividends or interest to their non-exempt customers, shareholders, or certificate holders.

Exempt organizations and individuals who reasonably believe they will owe no tax will not be subject to withholding if they file exemption certificates with the withholding agent. Furthermore, the proposal will be designed to minimize overwithholding and the period during which a taxpayer is owed a refund.

Under the proposal, it is estimated that tax collections for calendar year 1981 will increase by $2.1 billion and $2.3 and $2.6 billion in 1982 and 1983, respectively.

A detailed description of the proposal will be provided in a separate technical explanation.

This proposal is different from the 1962 proposal.

The President's proposal meets the objections that were raised to the proposal offered in 1962.

Although any withholding system will have complexities, the present proposal has been designed with simplicity and administrative ease in mind. Much of the complexity of the 1962 proposal stemmed from the level at which withholding was made. The present proposal designates as the withholding agent the entity that has the best information to determine the status of the recipient of the investment income. This approach, although more decentralized, makes exemptions easier to administer and more closely parallels the wage withholding system.

Since 1962, the computer age has advanced us far along the road to solving administrative problems. As with the current information reporting system, taxpayers will receive reports showing the amount of investment income payable to them and the amount of tax withheld. They will not have to determine for themselves, as they would have in 1962, whether the amount of dividends and interest received was net of withholding or not.

Perhaps, in retrospect, installing a reporting system was the expedient approach in 1962. But in 1980, withholding is feasible and practical -- as well as useful in the effort to balance the budget.

Criticisms of the proposal

Despite the advantages of withholding, the proposal has been subject to some criticism. I would like to comment briefly on the main objections that have been raised.

Cost to withholding agents

One objection is that withholding agents will incur additional administrative costs. Eighty-seven percent of the interest and dividends covered by the proposal is already subject to information reporting. For these, withholding agents need only add the amount of withheld tax to the reporting statement, remit the withheld tax to the Internal Revenue Service, and adjust the payments to the payee accordingly. Although withholding will be extended to

instruments for which there is now no reporting, most of them are bearer securities held by corporations, and corporate recipients are exempt under the proposal.

Naturally there will be some start-up costs associated with adding withholding -- there are always costs when an existing system is modified. But with a reporting system largely in place, we do not anticipate high continuing costs of the system to withholding agents.

The principal new cost will result from the exemption system. In recognition of this, exemption certificates will be permanent until they are revoked.

Overall, however, withholding is a far better way to collect taxes than is an increase in the number of audits, record checks, and collection attempts by the Internal Revenue Service. All taxpayers would bear the cost of increased audit coverage through the higher taxes needed to pay for the personnel and equipment necessary to conduct thorough examinations of more returns. Perhaps more importantly, taxpayers would suffer the loss of privacy from more frequent audits, record checks and requests for detailed information. The success of the wage withholding system indicates that taxpayers prefer withholding as a way to pay their taxes.

<u>Overwithholding</u>

Some are worried that low-income taxpayers, particularly certain senior citizens who depend on interest and dividend income, will be overwithheld. The proposal will exempt individuals if they reasonably expect that they will owe no tax. This means that 70 percent of the senior population will be entirely exempt.

To deal with other problems of overwithholding and to contain the costs of instituting the withholding system within reasonable bounds, the Secretary will be given authority to provide additional individual exemptions by regulation. For example, the regulations could provide an exemption for married couples filing jointly who are at least age 65 and for whom, in both the prior year and the current year, interest and dividend income does not exceed a stated amount, such as $15,000, and total tax liability does not exceed 10 percent of their investment income.

Other individuals who incur tax liability will be able to reduce their estimated tax payments to take account of the tax withheld on their interest and dividends, including interest and dividends that are eligible for the exclusion provided by the Crude Oil Windfall Profit Tax Act. Wage-earners will be able to adjust for tax withheld on interest and dividends that are eligible for the exclusion by reducing the amount of tax withheld from their wages.

Depositary institutions will be permitted to withhold once at the end of the year on passbook accounts so that a taxpayer may apply for a refund shortly after the tax is withheld.

Impact on savings

Withholding does not change savings incentives for individuals who now comply with the tax laws. Any argument that the tax system should encourage people to save by offering them opportunities to underreport their income must be rejected out-of-hand. Savings incentives in the form of opportunities for evasion promote inequity, undermine the integrity of the tax system, and are a grossly inefficient means of encouraging savings.

Some argue that the proposal will discourage savings by reducing the yield on savings. This argument confuses a change in the method of paying taxes, such as through withholding, with a change in the overall level of taxation. If taxes are withheld, the amount withheld becomes a credit that taxpayers can claim against their final tax liability. Taxpayers may then adjust their estimated tax payments or simply reduce the balance due at the time that they file their returns.

Even if a taxpayer decides to make no adjustment during the year, he or she will only lose interest on the amount of tax that would not have been paid as early in the year if there were no withholding. Since the withheld tax on interest paid on a typical savings account averages less than one percent of asset value over the course of the year, at worst the "loss" of interest on the withheld tax would be less than one-tenth of one percent of asset value. Moreover, most of this loss will be avoided if withholding on passbook-type accounts occurs only at year end, rather than quarterly.

Thus, the argument that savings will be adversely affected by this proposal is grossly overstated. Inflationary expectations and restricted yields on passbook savings have been the principal savings disincentives in recent years. Congress, with the full support of the Administration, has already acted to lift interest ceilings through the phase-out of Regulation Q. Current economic problems should not lead us to advocate lower compliance with the tax laws as a policy for increasing savings.

Conclusion

Withholding on wages proves that withholding is the most economical way to achieve high levels of compliance in the payment of taxes. The Administration's proposal for withholding on interest and dividends will impose minimal burdens on withholding agents. It will also protect individuals with little or no tax liability.

Congress and the Administration have at all times a joint responsibility to make certain that the Federal government collects all taxes due it. In this period of fiscal austerity, we can ill afford the needless loss of billions of dollars in taxes that are not being paid on interest and dividends. Withholding on investment income is the most sensible and effective answer to this major compliance problem.

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ırtment of the TREASURY

IGTON, D.C. 20220 TELEPHONE 566-2041

NEWS

'OR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE April 30, 1980

TREASURY MAY QUARTERLY FINANCING

The Treasury will raise about $3,500 million of new cash ınd refund $1,712 million of notes and $2,326 million of cash ıanagement bills maturing May 15, 1980, by issuing $3,500 ıillion of 3-1/4-year notes, $2,000 million of 9-1/2-year notes ınd $2,000 million of 30-year bonds. The 9-1/2-year notes will ›e an addition to the 10-3/4% notes of Series B-1989 originally .ssued November 15, 1979. The public currently holds $1,981 ıillion of the outstanding 10-3/4% notes.

The $1,712 million of maturing notes are those held by the ›ublic, including $38 million held, as of today, by Federal ₹eserve Banks as agents for foreign and international monetary ıuthorities. In addition to the public holdings, Government ıccounts and Federal Reserve Banks, for their own accounts, ıold $5,553 million of the maturing notes that may be refunded ›y issuing additional amounts of new securities. Additional ımounts of the new securities may also be issued to Federal ₹eserve Banks, as agents for foreign and international monetary ıuthorities, to the extent that the aggregate amount of tenders for such accounts exceeds the aggregate amount of maturing ıotes held by them.

Details about each of the new securities are given in the attached "highlights" of the offering and in the official offering circulars.

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(over)

HIGHLIGHTS OF TREASURY
OFFERINGS TO THE PUBLIC
MAY 1980 FINANCING
TO BE ISSUED MAY 15, 1980

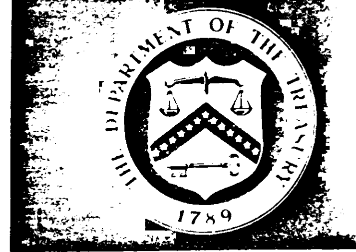
April 30, 1980

Amount Offered:			
To the public	$3,500 million	$2,000 million	$2,000 million
Description of Security:			
Term and type of security	3-1/4-year notes	9-1/2-year notes	30-year bonds
Series and CUSIP designation	Series K-1983 (CUSIP No. 912827 KR 2)	Series B-1989 (CUSIP No. 912827 KC 5)	Bonds of 2005-2010 (CUSIP No. 912810 CP 1)
Maturity date	August 15, 1983	November 15, 1989	May 15, 2010
Call date	No provision	No provision	May 15, 2005
Interest coupon rate	To be determined based on the average of accepted bids	10-3/4%	To be determined based on the average of accepted bids
Investment yield	To be determined at auction	To be determined at auction	To be determined at auction
Premium or discount	To be determined after auction	To be determined after auction	To be determined after auction
Interest payment dates	February 15 and August 15 (first payment on February 15, 1981)	November 15 and May 15	November 15 and May 15
Minimum denomination available	$5,000	$1,000	$1,000
Terms of Sale:			
Method of sale	Yield Auction	Price Auction	Yield Auction
Accrued interest payable by investor	None	None	None
Preferred allotment	Noncompetitive bid for $1,000,000 or less	Noncompetitive bid for $1,000,000 or less	Noncompetitive bid for $1,000,000 or less
Payment by non-institutional investors	full payment to be submitted with tender	full payment to be submitted with tender	full payment to be submitted with tender
Deposit guarantee by designated institutions	Acceptable	Acceptable	Acceptable
Dates:			
Deadline for receipt of tenders	Tuesday, May 6, 1980, by 1:30 p.m., EDST	Wednesday, May 7, 1980, by 1:30 p.m., EDST	Thursday, May 8, 1980, by 1:30 p.m., EDST
Settlement date (final payment due from institutions)			
a) cash or Federal funds	Thursday, May 15, 1980	Thursday, May 15, 1980	Thursday, May 15, 1980
b) readily collectible check	Monday, May 12, 1980	Monday, May 12, 1980	Monday, May 12, 1980
Delivery date for coupon securities	Friday, May 23, 1980	Thursday, May 15, 1980	Wednesday, May 28, 1980

Department of the TREASURY

WASHINGTON, D.C. 20220 TELEPHONE 566-2041

NEWS



April 30, 1980

Memorandum to the Press:

The Chrysler Loan Guarantee Board will meet at 3:15 p.m. Thursday, May 1 in the Board Room of the Federal Reserve Board.

The Board will continue its consideration of issuing a commitment for $1.5 billion in Federal loan guarantees to the Chrysler Corporation.

TALKING POINTS
FOR THE
FINANCING PRESS CONFERENCE
APRIL 30, 1980

1. This afternoon we are announcing the terms of our regular May quarterly refunding. I will also discuss the Treasury's financing requirements for the balance of the current quarter and our estimated cash needs for the July - September quarter.

2. We are offering $7.5 billion of securities to refund $1.7 billion of publicly-held coupon securities maturing on May 15. In addition, $2.3 billion cash management bills mature on that date. Taking these bills into consideration results in approximately $3.5 billion of new cash being raised in the refunding. The three securities are:

    -- First, a 3-year, 3-month note in the amount of $3.5 billion maturing on August 15, 1983. This note will be auctioned on a yield basis on Tuesday, May 6. The minimum denomination will be $5,000.

    -- Second, a 9-year, 6-month note in the amount of $2.0 billion maturing November 15, 1989. This note will be

a reopening of an existing security and will be auctioned on a price basis on Wednesday, May 7. The minimum demonination will be $1,000.

-- Third, a 30-year bond in the amount of $2.0 billion maturing on May 15, 2010 and callable beginning May 15, 2005. This bond will be auctioned on a yield basis on Thursday, May 8. The minimum denomination will be $1,000.

On each of the three issues, we will accept noncompetitive tenders of up to $1,000,000.

3. For the current April - June quarter, we estimate our net market financing will total about $6.4 billion, assuming a $15 billion cash balance at the end of June.

4. Thus far, not including this refunding, we have issued or announced about $.7 billion in net new marketable borrowing. This was accomplished as follows:

   -- $3.1 billion of new cash from the additions to the weekly bill auctions.

   -- $1.6 billion in connection with the 1-year bill auctions which settled on April 1 and 29, respectively.

-- $1.5 billion in the 15-year, 1-month bond which settled on April 8.

-- $1.3 billion of new cash in the April 2-year note settling today.

-- Also, during April, $9.1 billion of cash management bills were issued and $9.0 billion were redeemed, and on May 1, $6.9 billion of cash management bills will be redeemed. The net effect of these transactions is a paydown of $6.8 billion in cash management bills.

5. The net amount raised so far of $.7 billion plus the $3.5 billion raised in the May refunding provides $4.2 billion of the $6.4 billion need for the quarter.

6. Our remaining net financing need of $2.2 billion plus the financing required because of the expected paydown of the $9.1 billion of June cash management bill maturities will require net new borrowing of $11.3 billion in the remainder of this quarter. This could be met by continued additions to the regular weekly and monthly bills, a possible intermediate note in early June in the 5 - 6 year range and possible additions to the 2- and 4-year notes in May and June. Shorter-dated cash management bills to accommodate temporary cash needs may also be utilized within the quarter.

7. Our net market borrowing need in the third quarter of calendar year 1980 is currently estimated in the range of $11 to 14 billion, assuming a $15 billion cash balance at the end of September.

NET MARKET BORROWING

April - June 1980

Total		6.4
Cash Management Bills:		
April Issues	9.1	
April Retirements	9.0	
May Maturities	9.2	
June Maturities	9.1	
Net Paydown		18.2
Other Net Borrowing:		24.6
Done [1]		
15 year - 1 month bond	1.5	
2 year note	1.3	
Regular bills	4.7	
Total		7.5
To Be Done		17.1

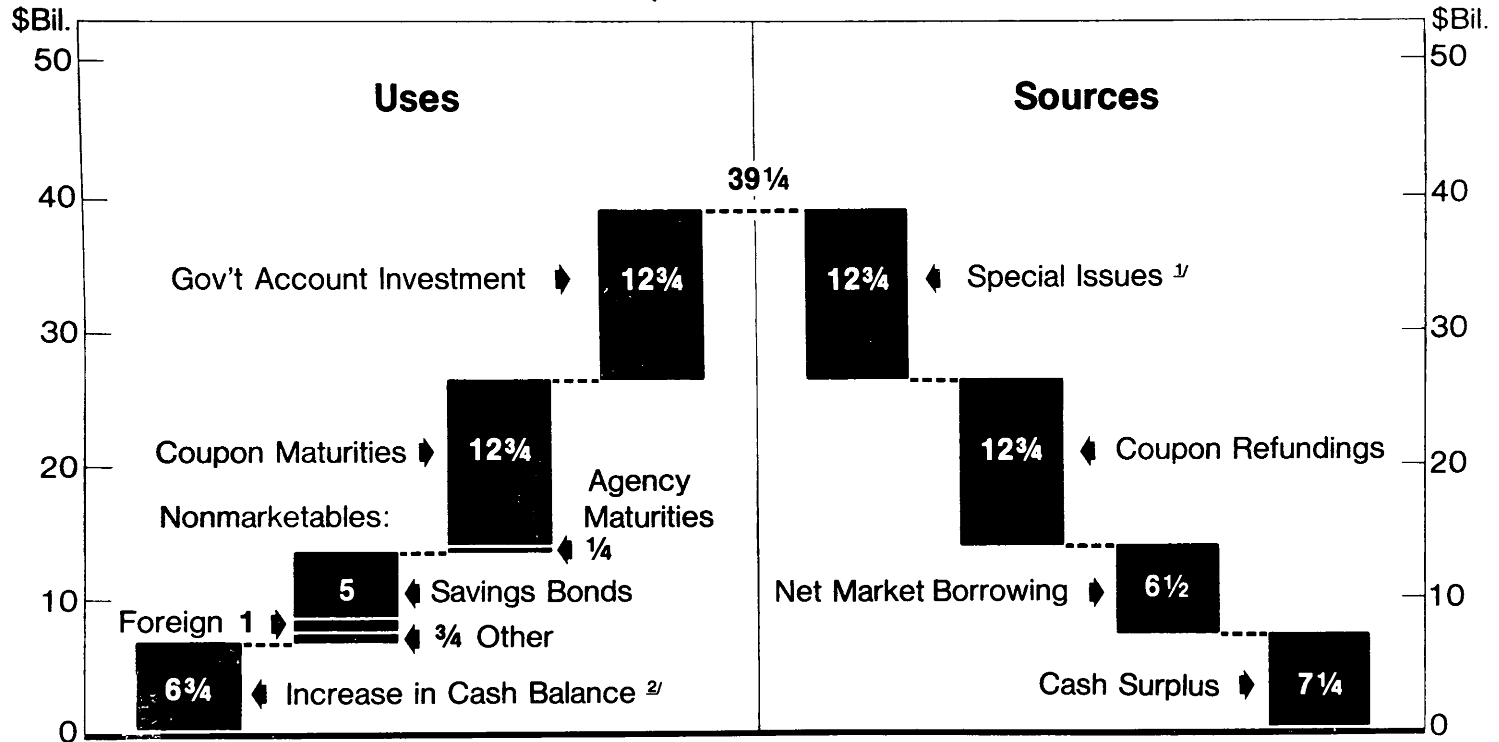
1/ Issued or announced through April 25, 1980.

Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-24

TREASURY FINANCING REQUIREMENTS

April - June 1980



1/ Net of 2¼ billion maturities other than special issues.

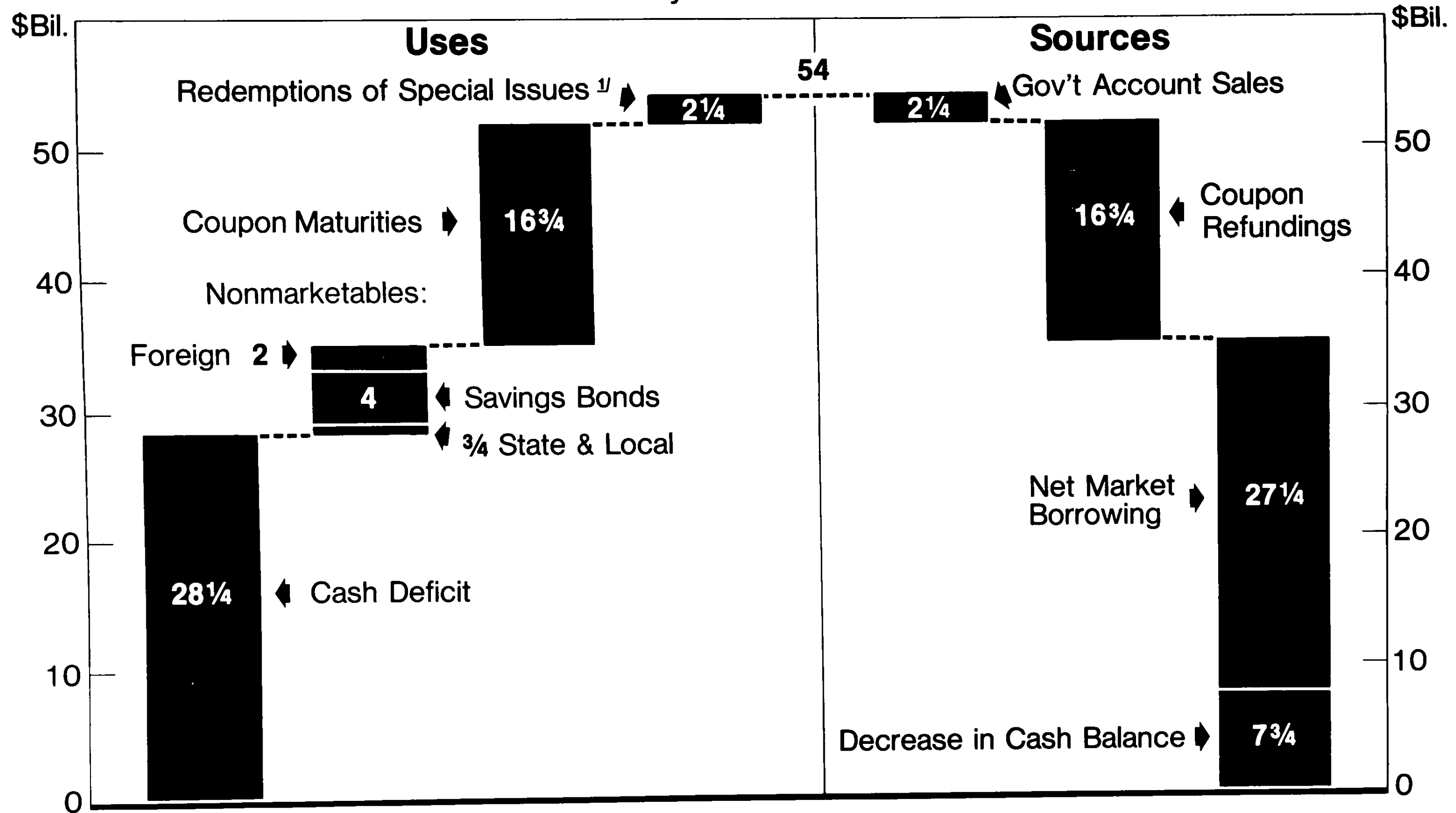
2/ Assumes $ 15 billion June 30, 1980 cash balance.

Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-21

TREASURY FINANCING REQUIREMENTS

January - March 1980

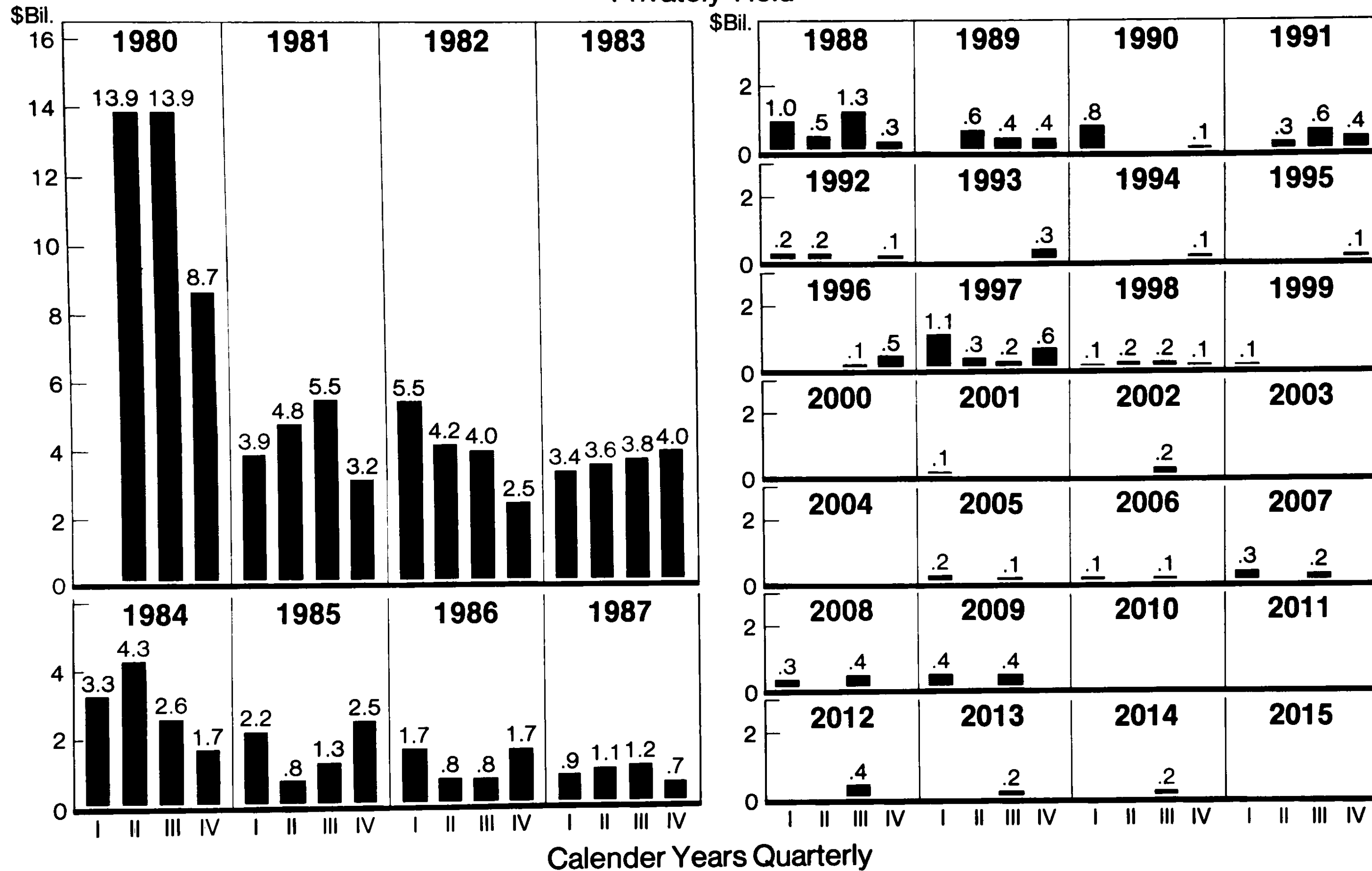


1/ Includes maturing marketable securities of $ ¼ billion.

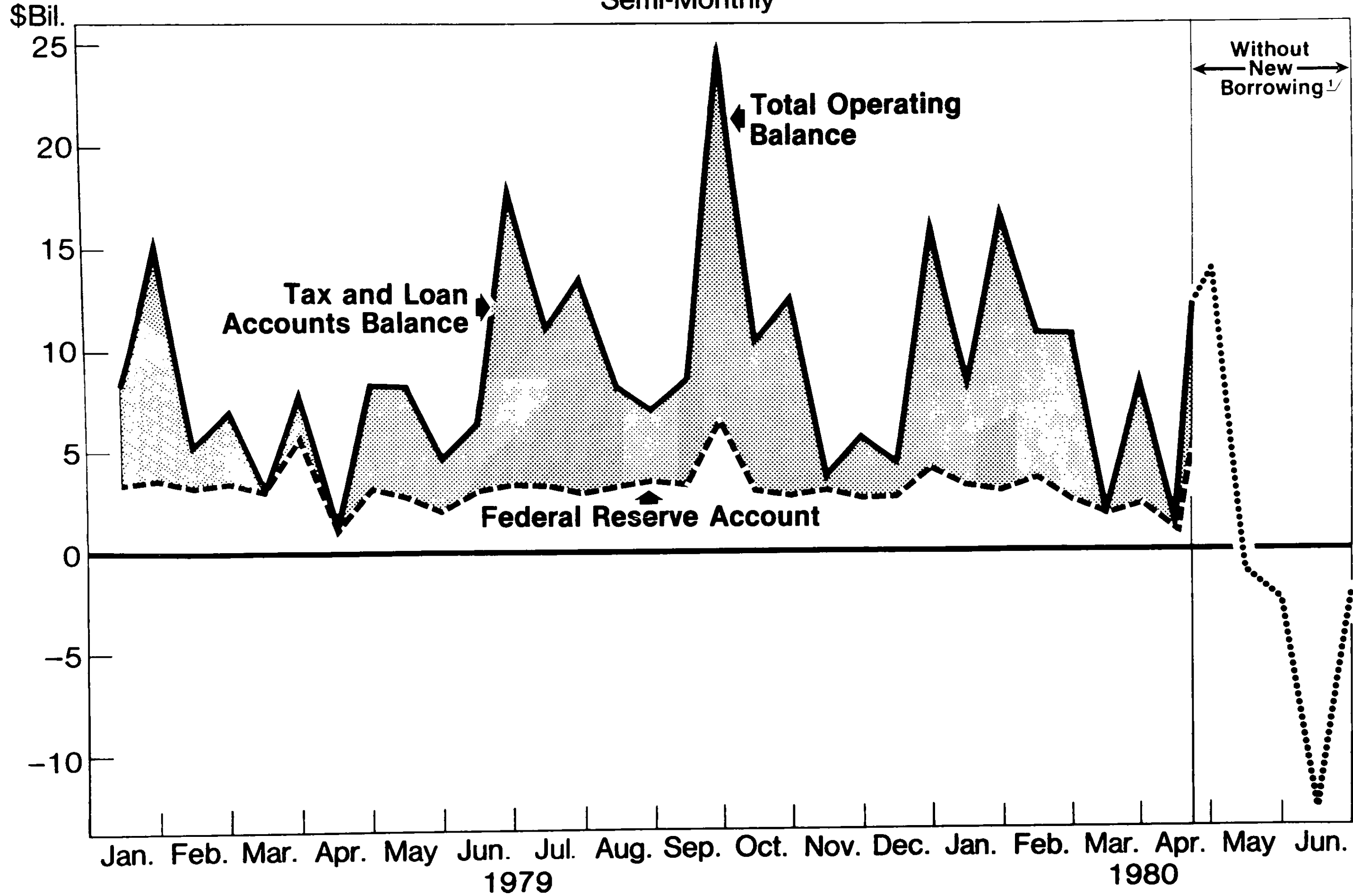
Office of the Secretary of the Treasury
Office of Government Financing

AGENCY MATURITIES 1/

Privately Held

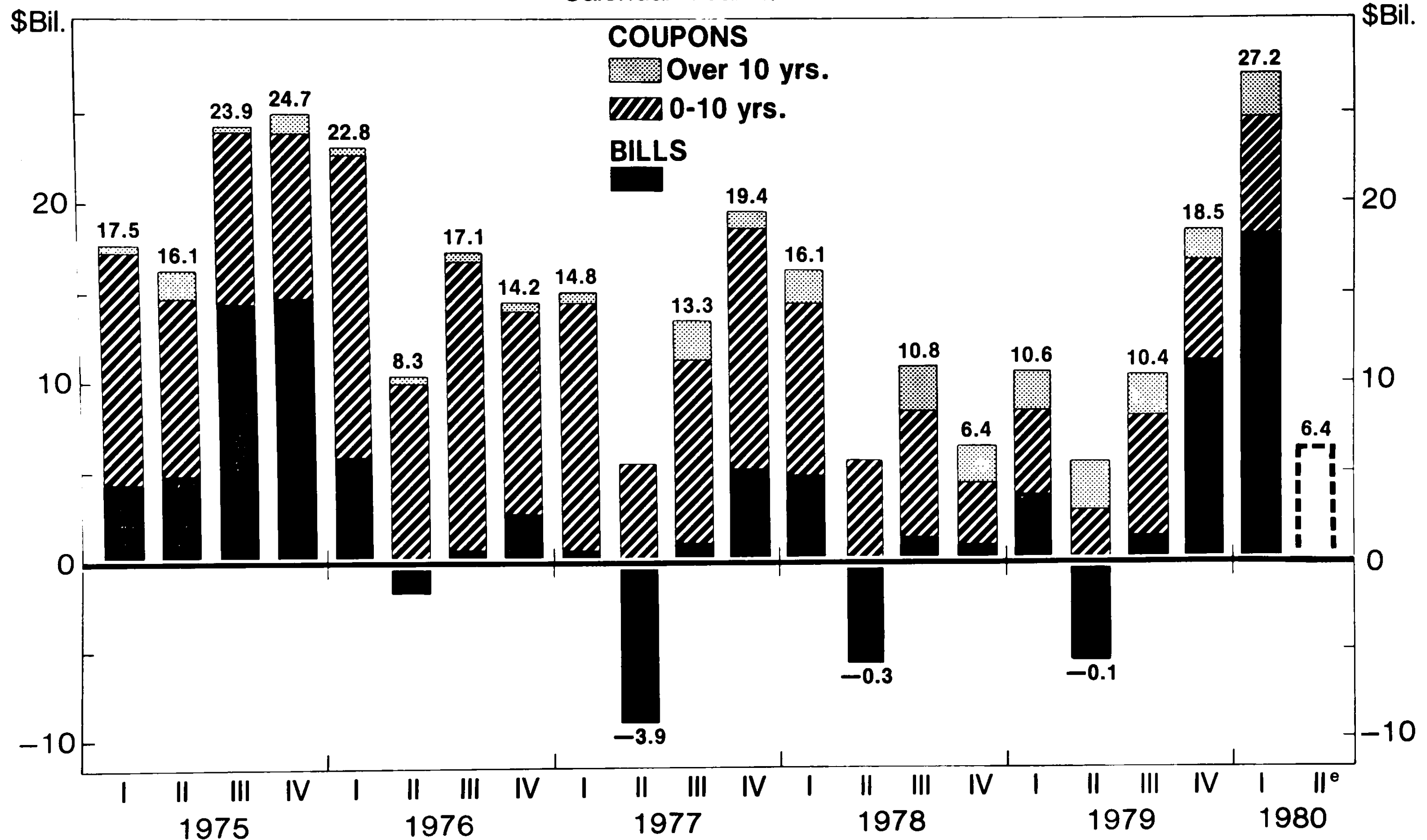


1/Issued or announced through March 31, 1980


TREASURY OPERATING CASH BALANCE
Semi-Monthly
$Bil.
25
20
15
10
5
0
−5
−10
Without New Borrowing 1/
Total Operating Balance
Tax and Loan Accounts Balance
Federal Reserve Account
Jan.
Feb.
Mar.
Apr.
May
Jun.
Jul.
Aug.
Sep.
Oct.
Nov.
Dec.
Jan.
Feb.
Mar.
Apr.
May
Jun.
1979
1980
1/ Assumes refunding of maturing issues except for cash management bills.
Office of the Secretary of the Treasury
Office of Government Financing
April 29, 1980-6

TREASURY NET MARKET BORROWING[1/]

Calendar Year Quarters

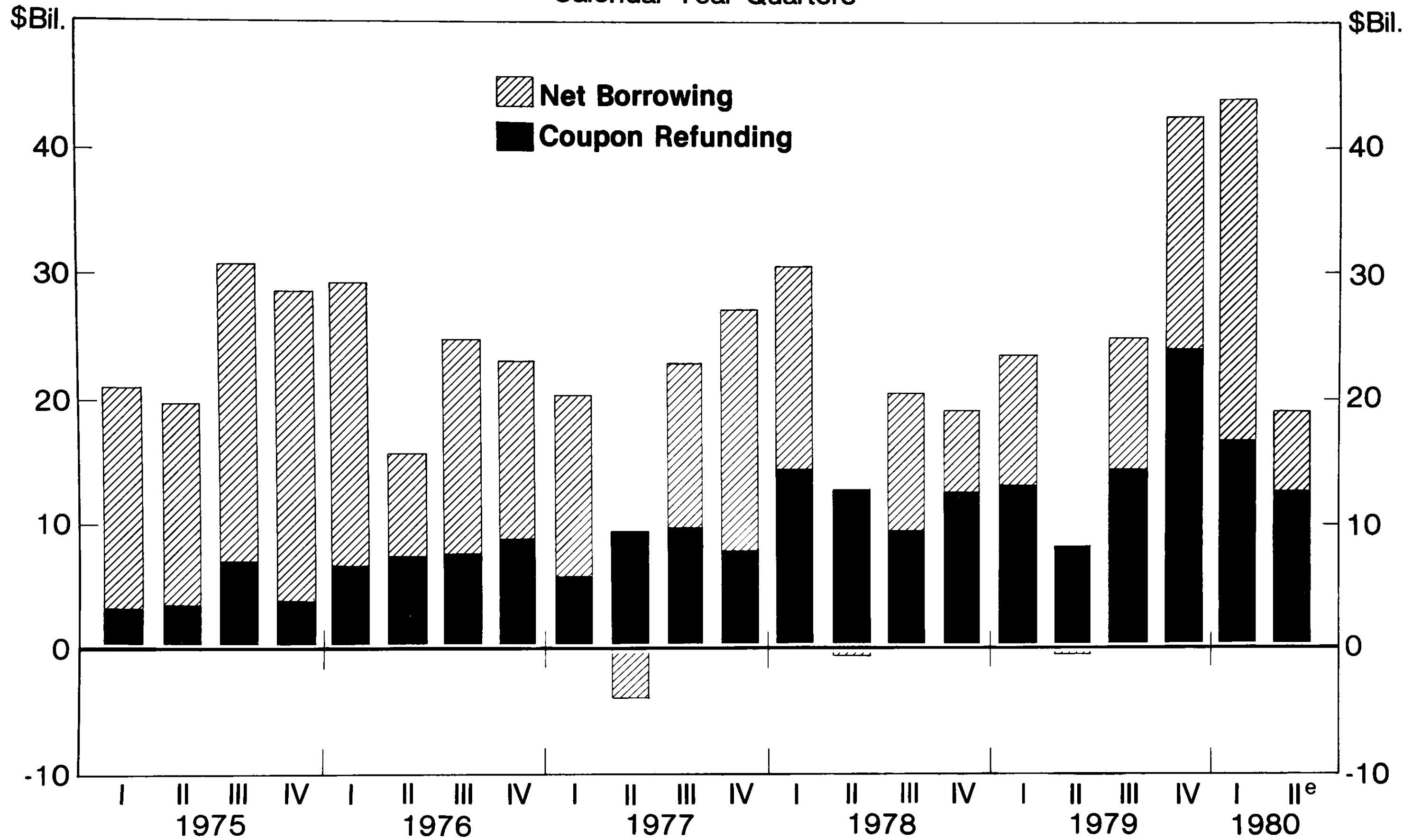


1/ Excludes Federal Reserve and Government Account Transactions.

^e estimate

Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-3



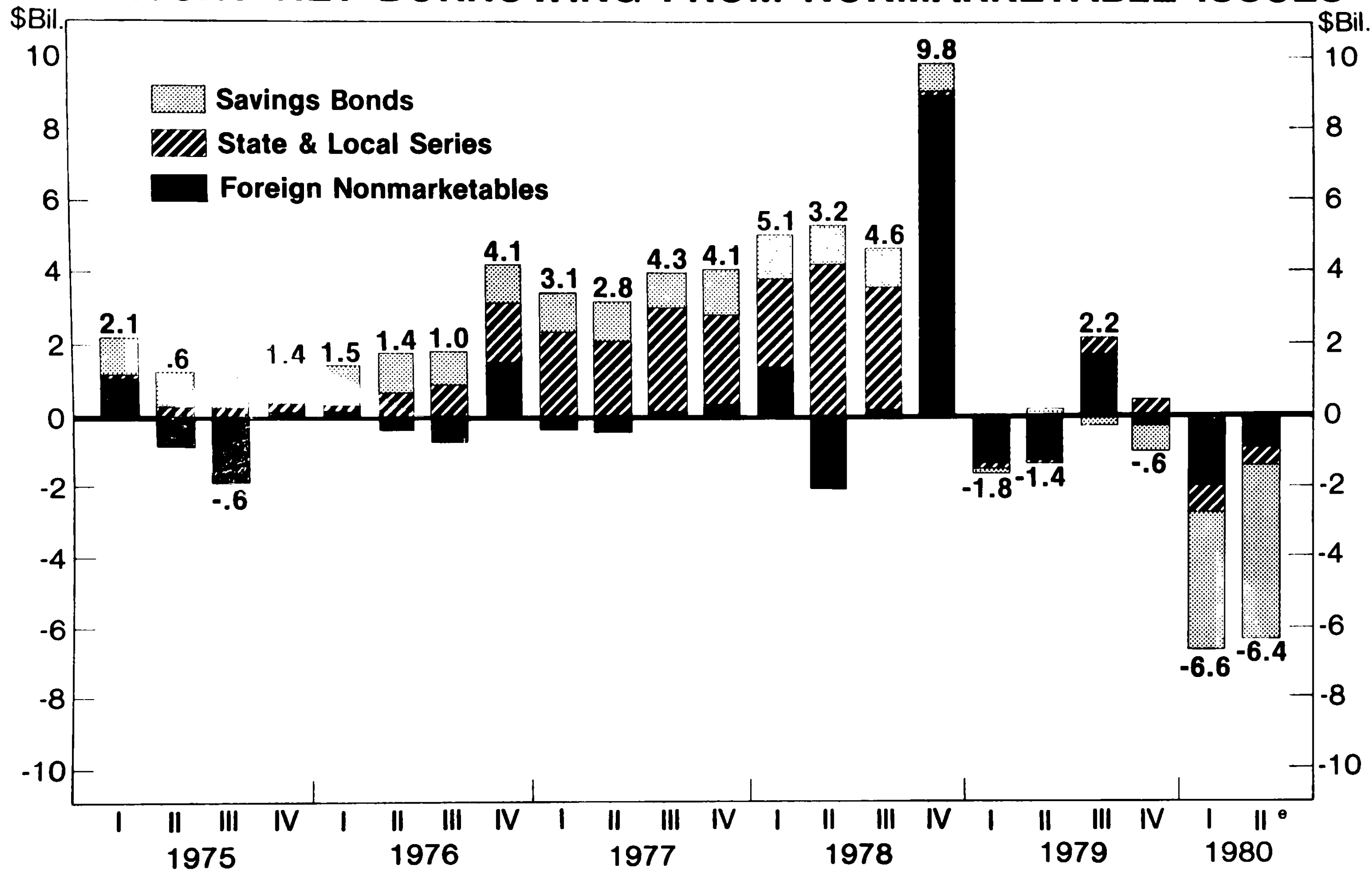
1/ Excludes Federal Reserve and Government Account Transactions.

e estimate

Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-1

TREASURY NET BORROWING FROM NONMARKETABLE ISSUES

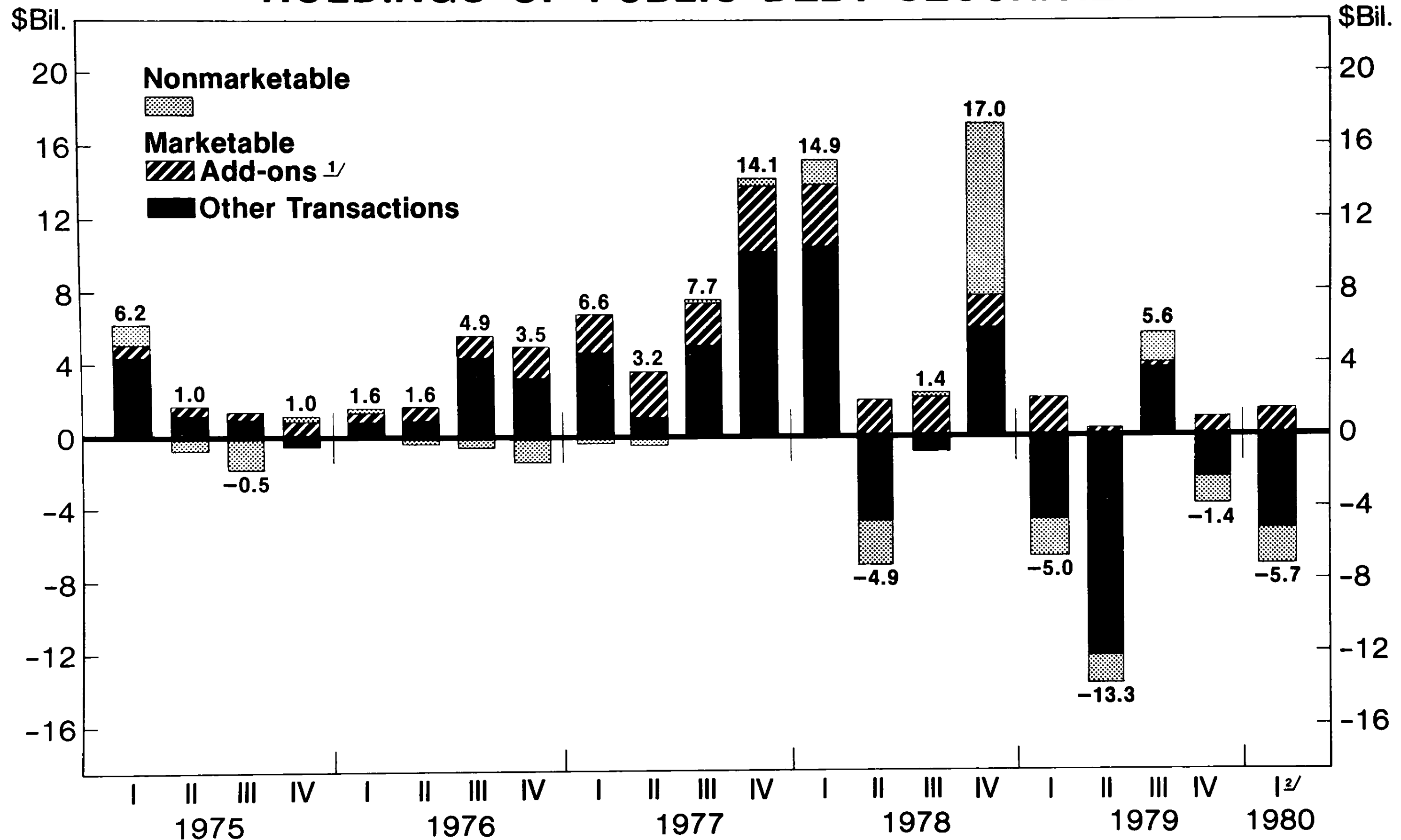


e estimate

Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-4

QUARTERLY CHANGES IN FOREIGN AND INTERNATIONAL HOLDINGS OF PUBLIC DEBT SECURITIES



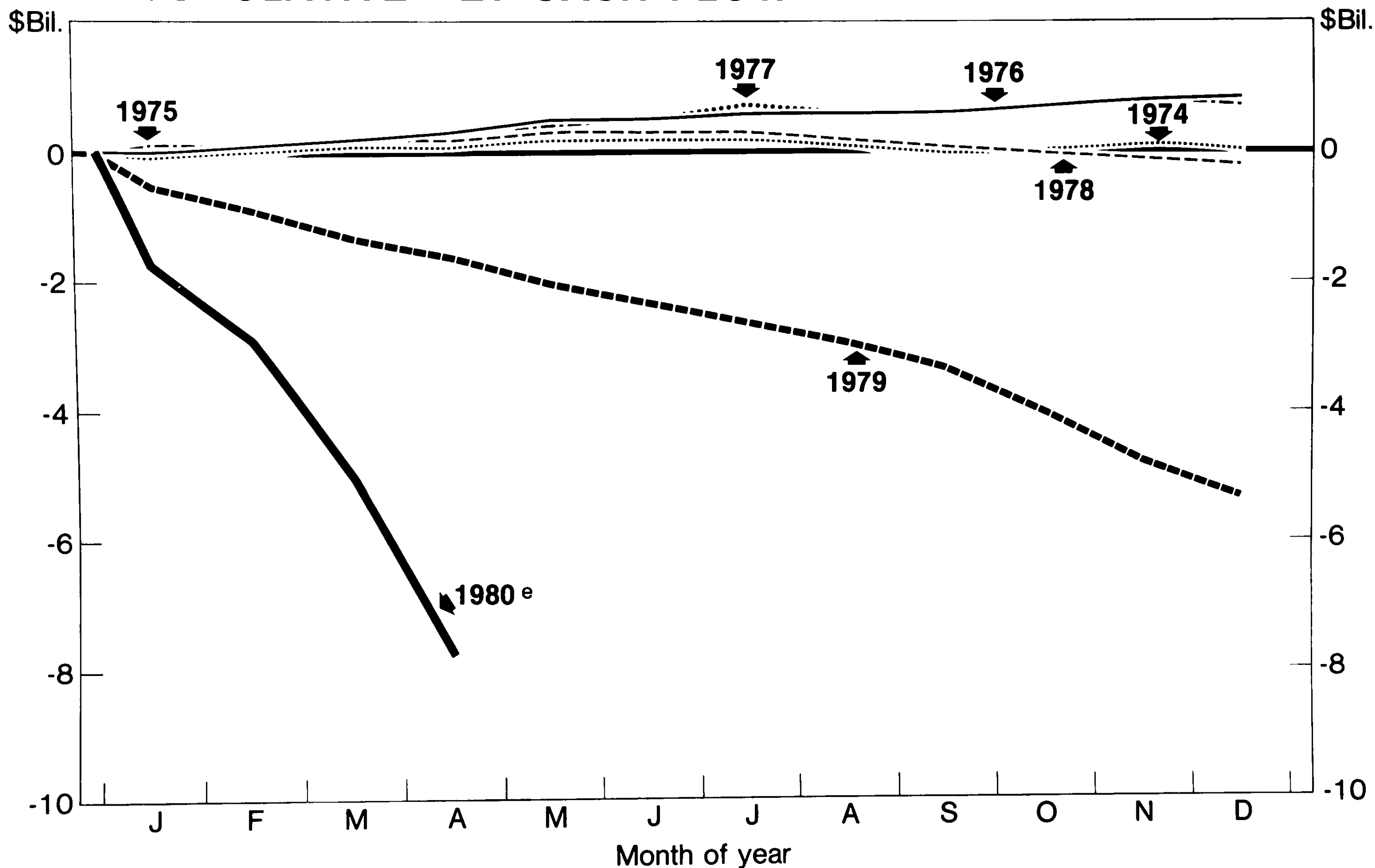
1/ F.R.B. Purchases of marketable issues as agents for foreign and international monetary authorities for new cash.

2/ Partly estimated.

Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-2

CUMULATIVE NET CASH FLOW IN SAVINGS BONDS[1]



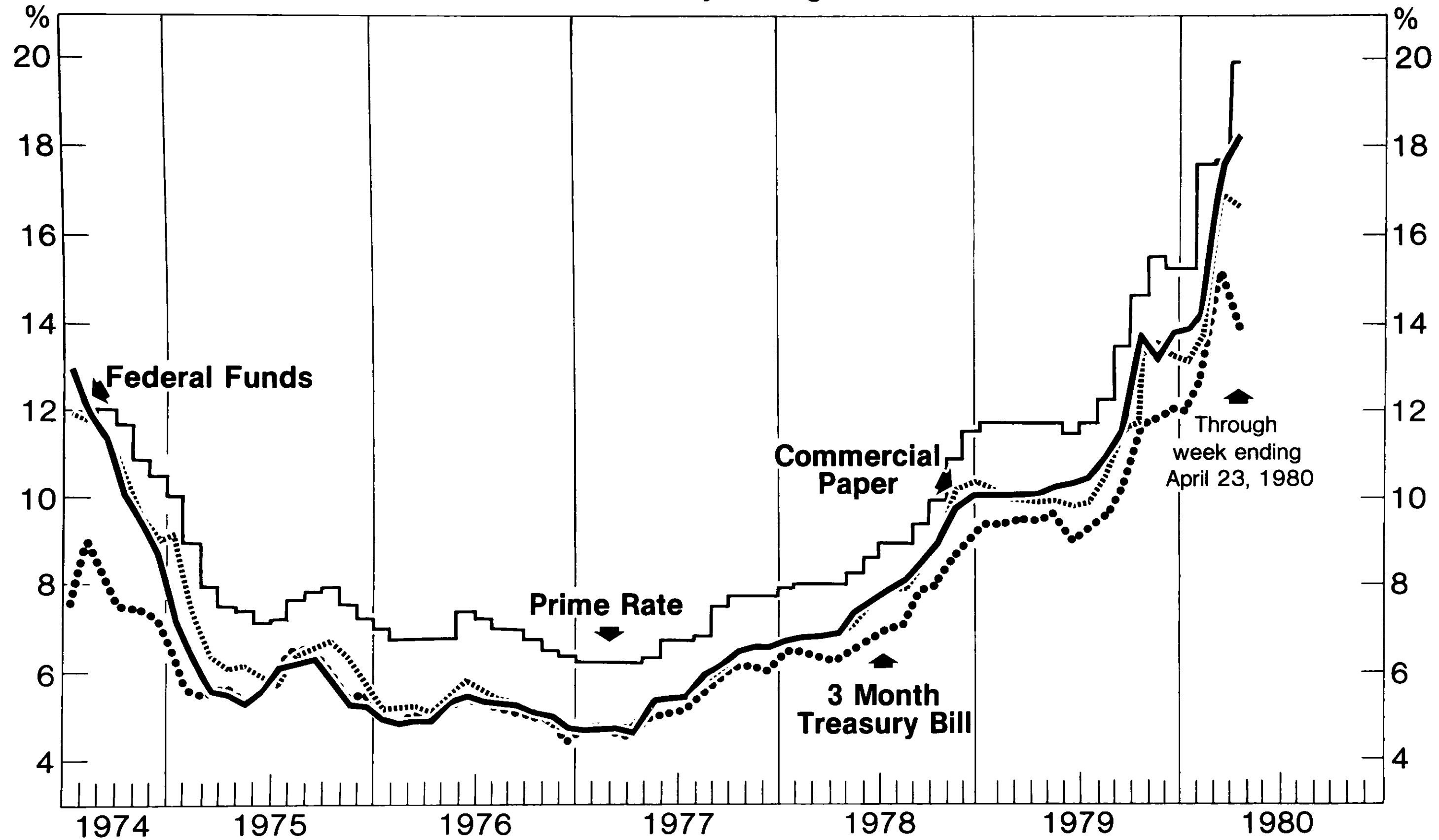
[1]/Cash sales less redemptions
e April partially estimated

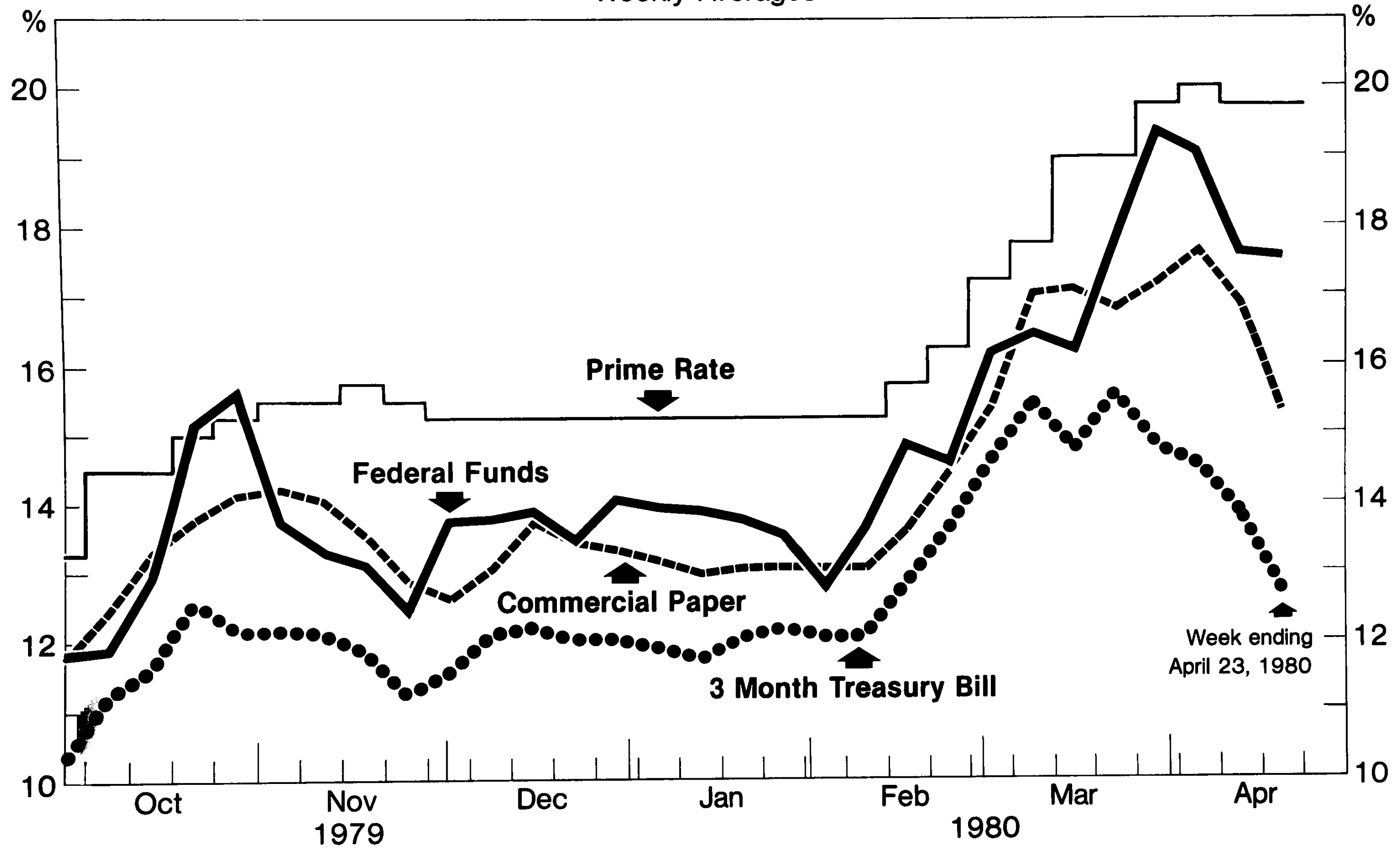
Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-15

SHORT TERM INTEREST RATES

Monthly Averages





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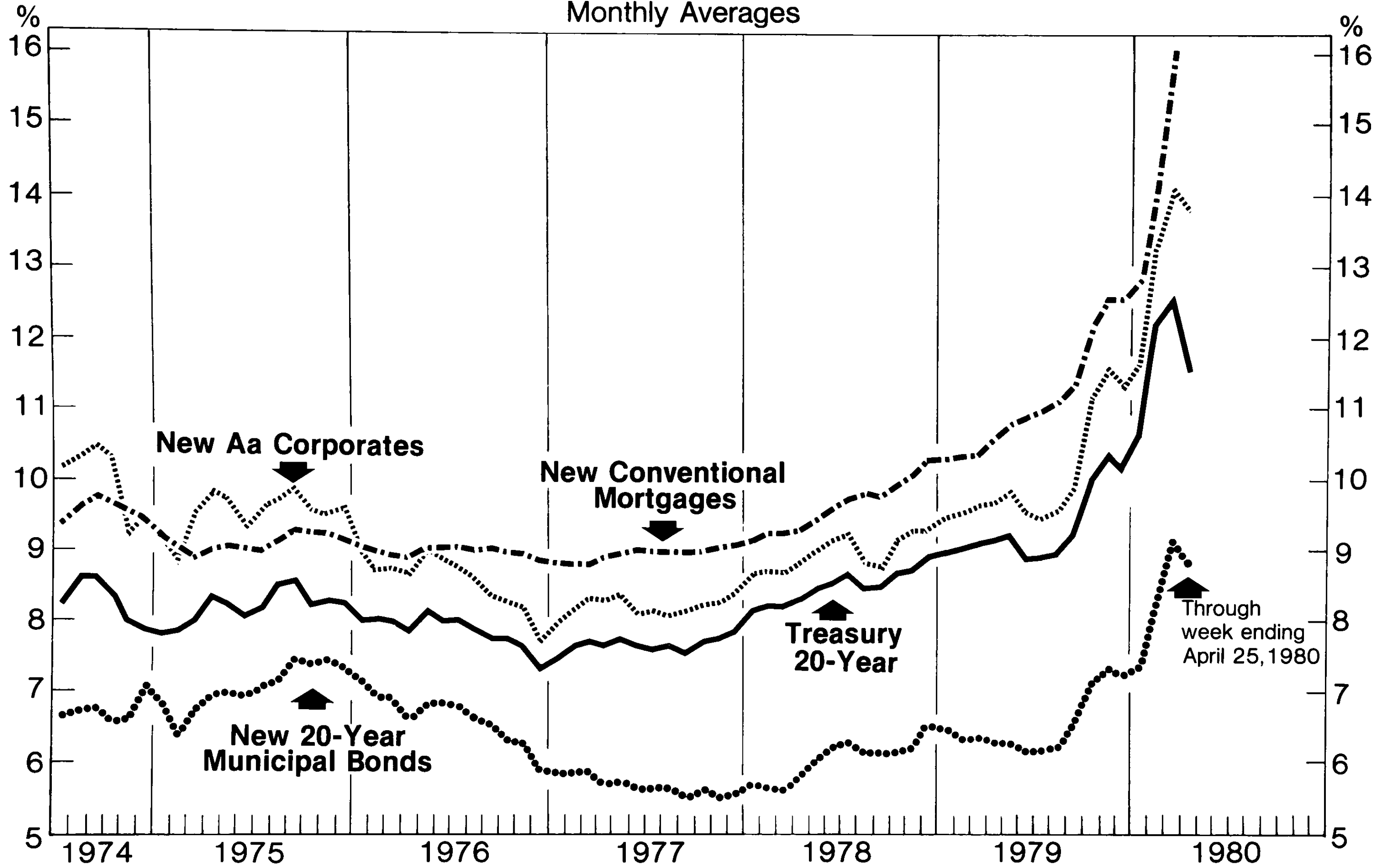
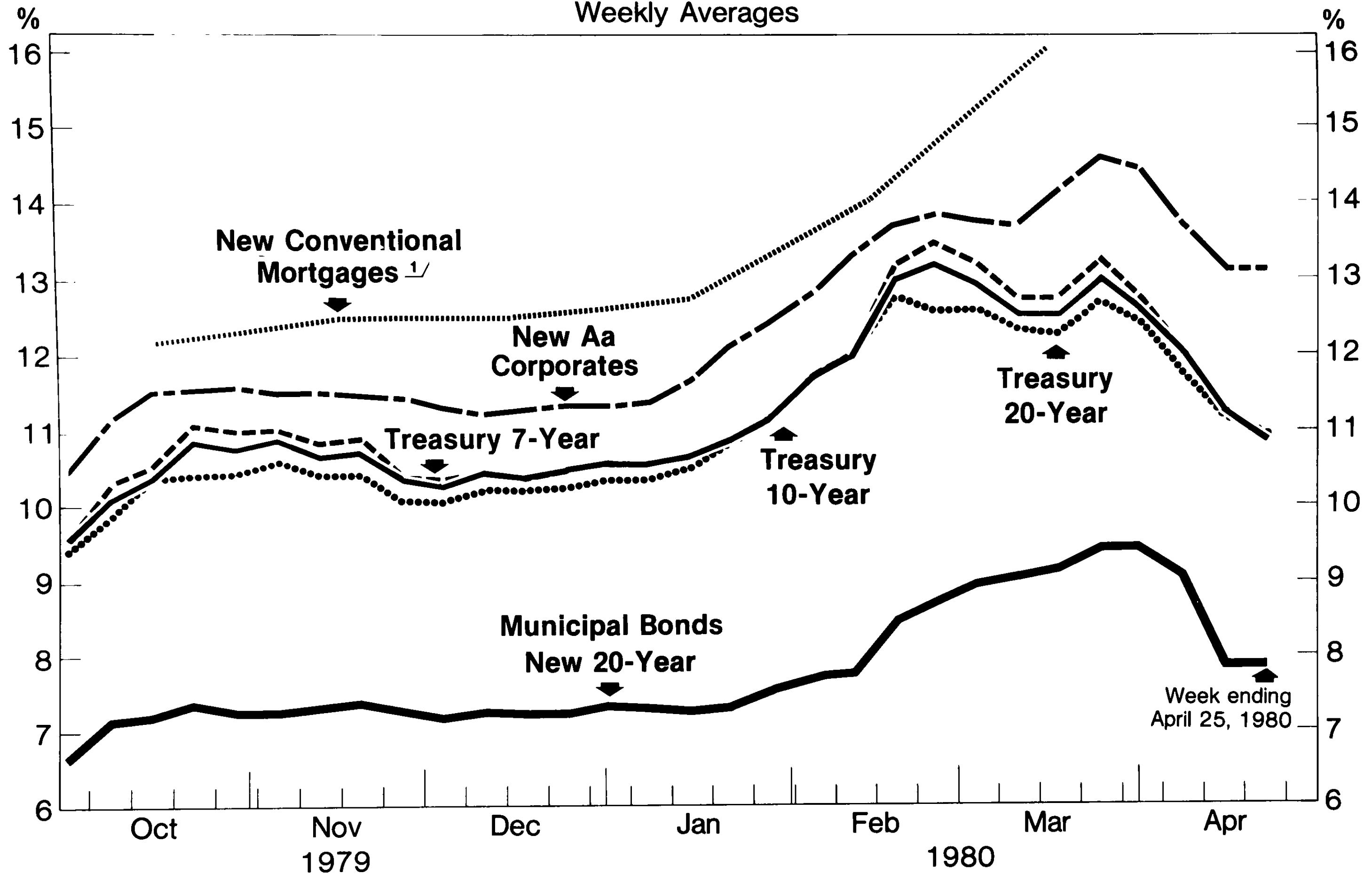
Office of Government Financing

April 29, 1980-8



Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-9



1/ Monthly figures - weekly data not available.

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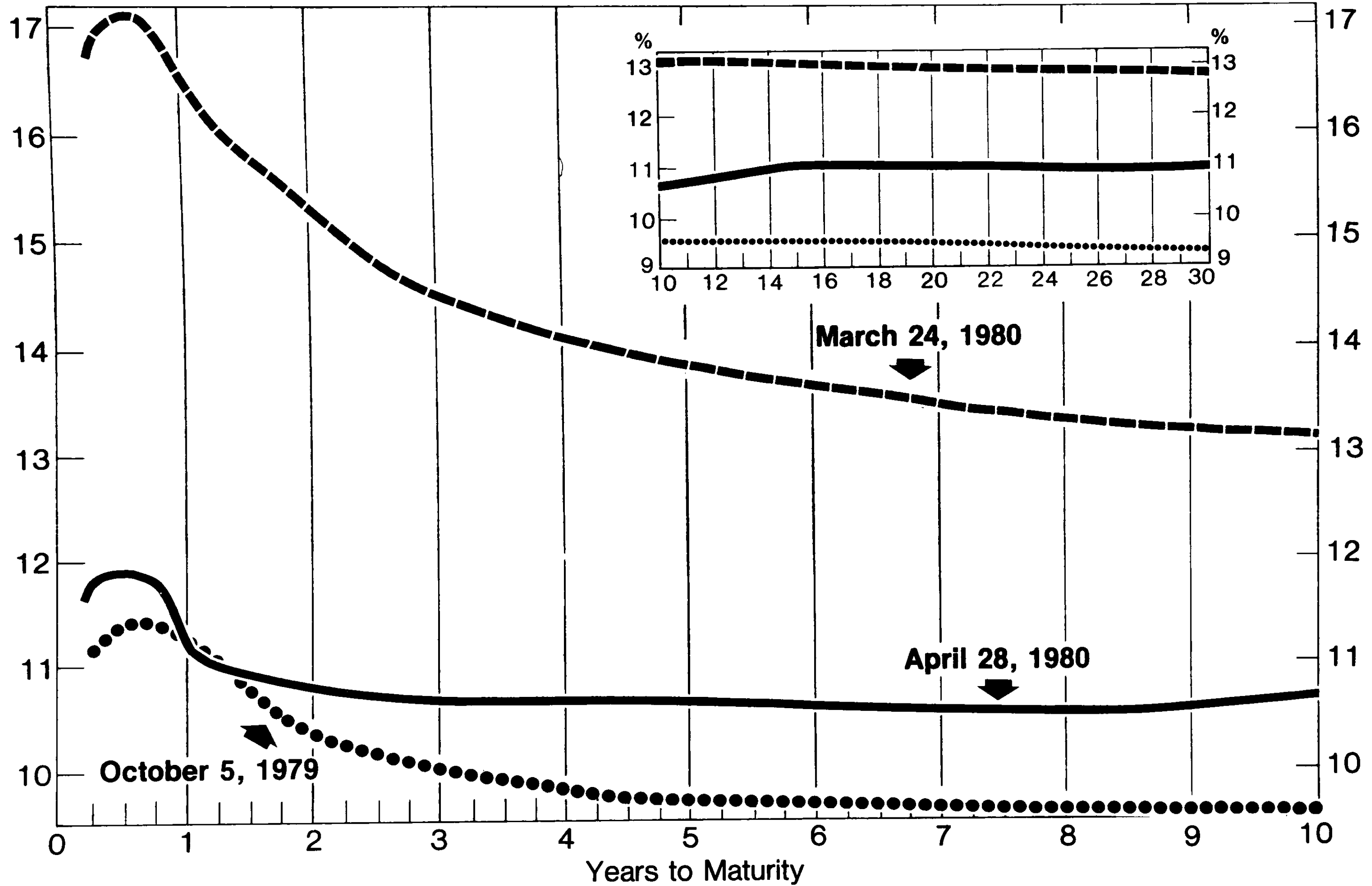
April 29, 1980-10



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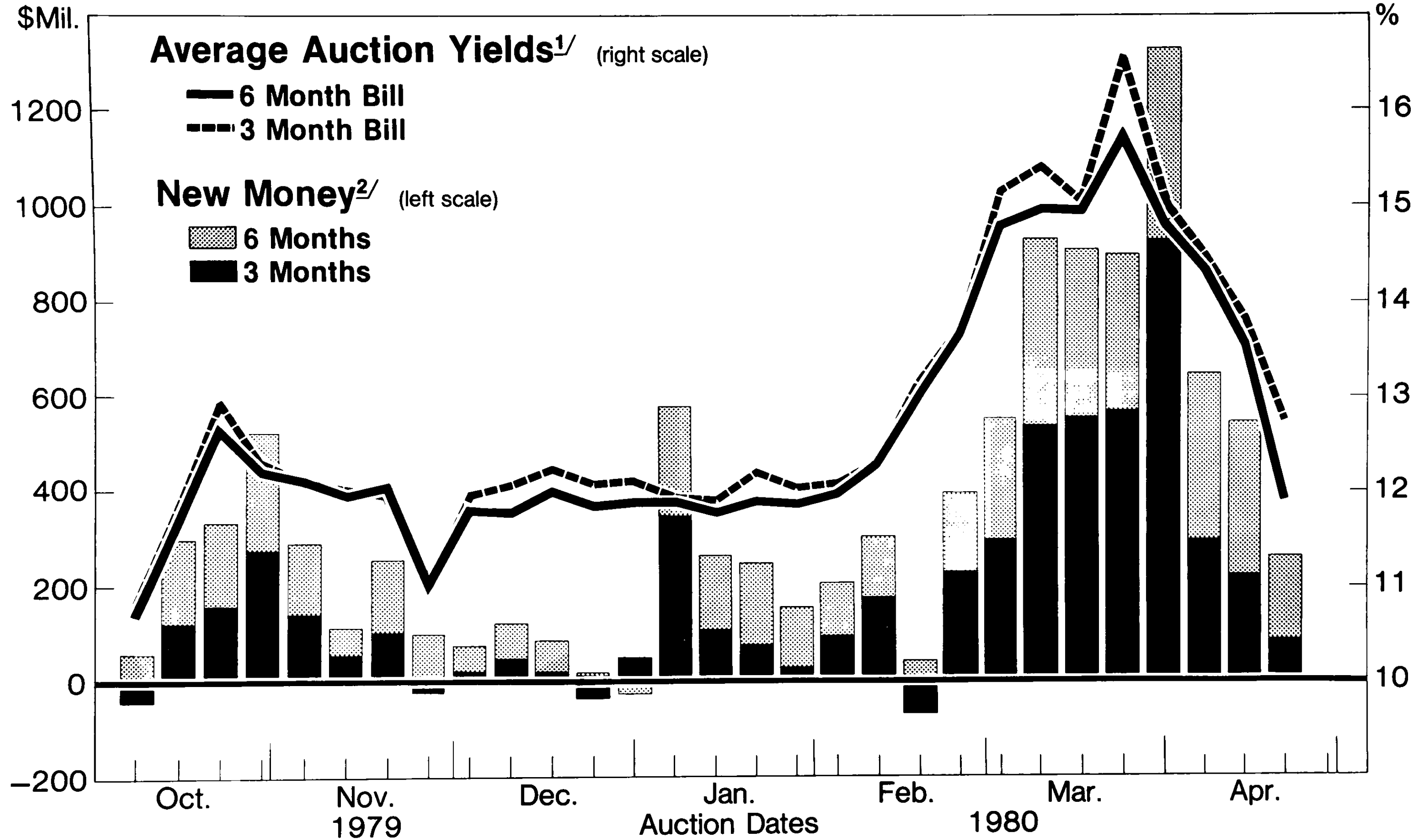
Office of Government Financing

April 29, 1980-20

NEW MONEY FROM NONCOMPETITIVE BIDS IN TREASURY BILL AUCTIONS AND AVERAGE AUCTION YIELDS



1/ Discount basis.

2/ New money is the difference between noncompetitive bids on the new issues and maturing bills previously bid noncompetitively.

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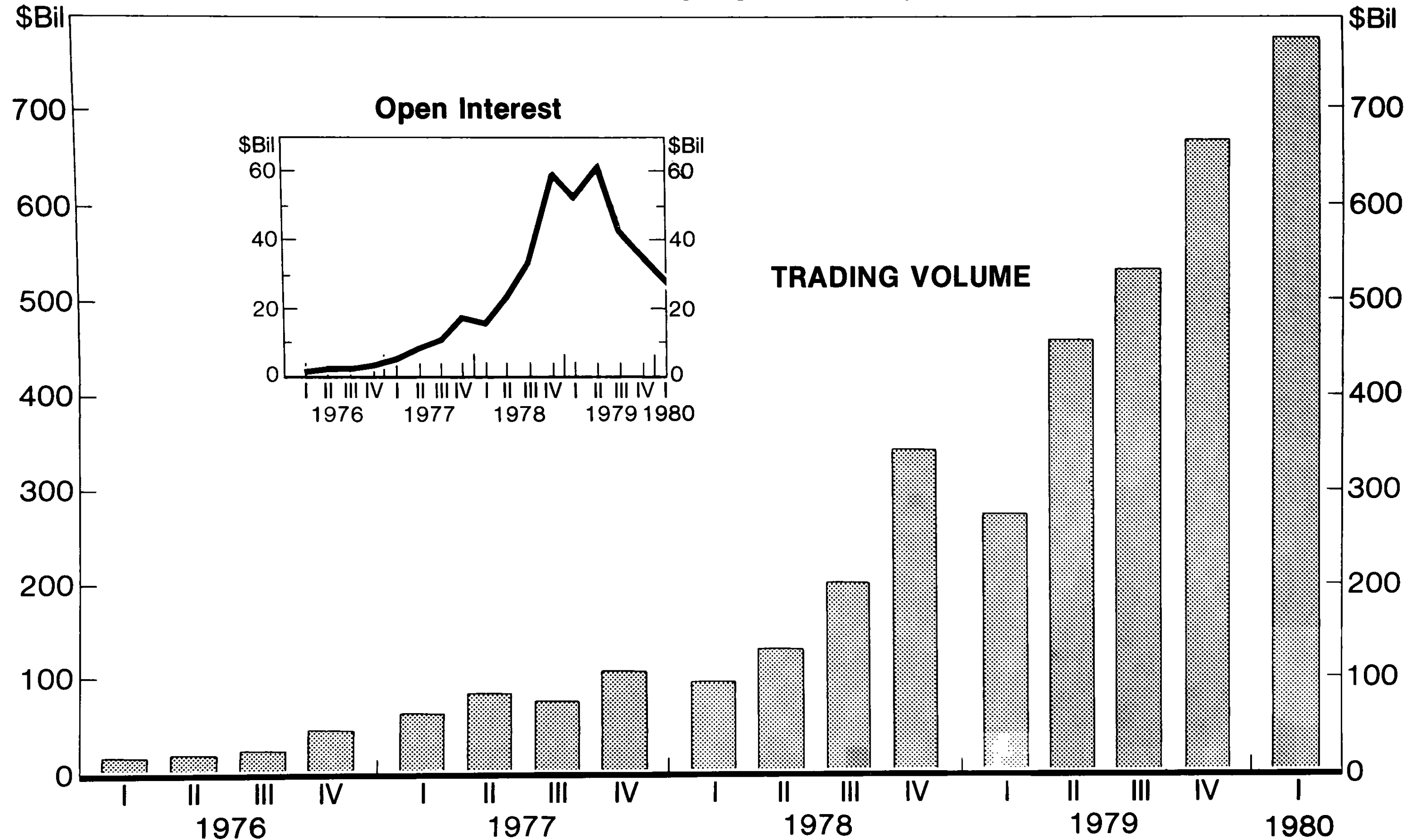
Office of Government Financing

April 29, 1980-5

TRADING VOLUME AND OPEN INTEREST IN 90 DAY TREASURY BILL FUTURES CONTRACTS[1]



[1] Contracts traded on the International Monetary Market (IMM)

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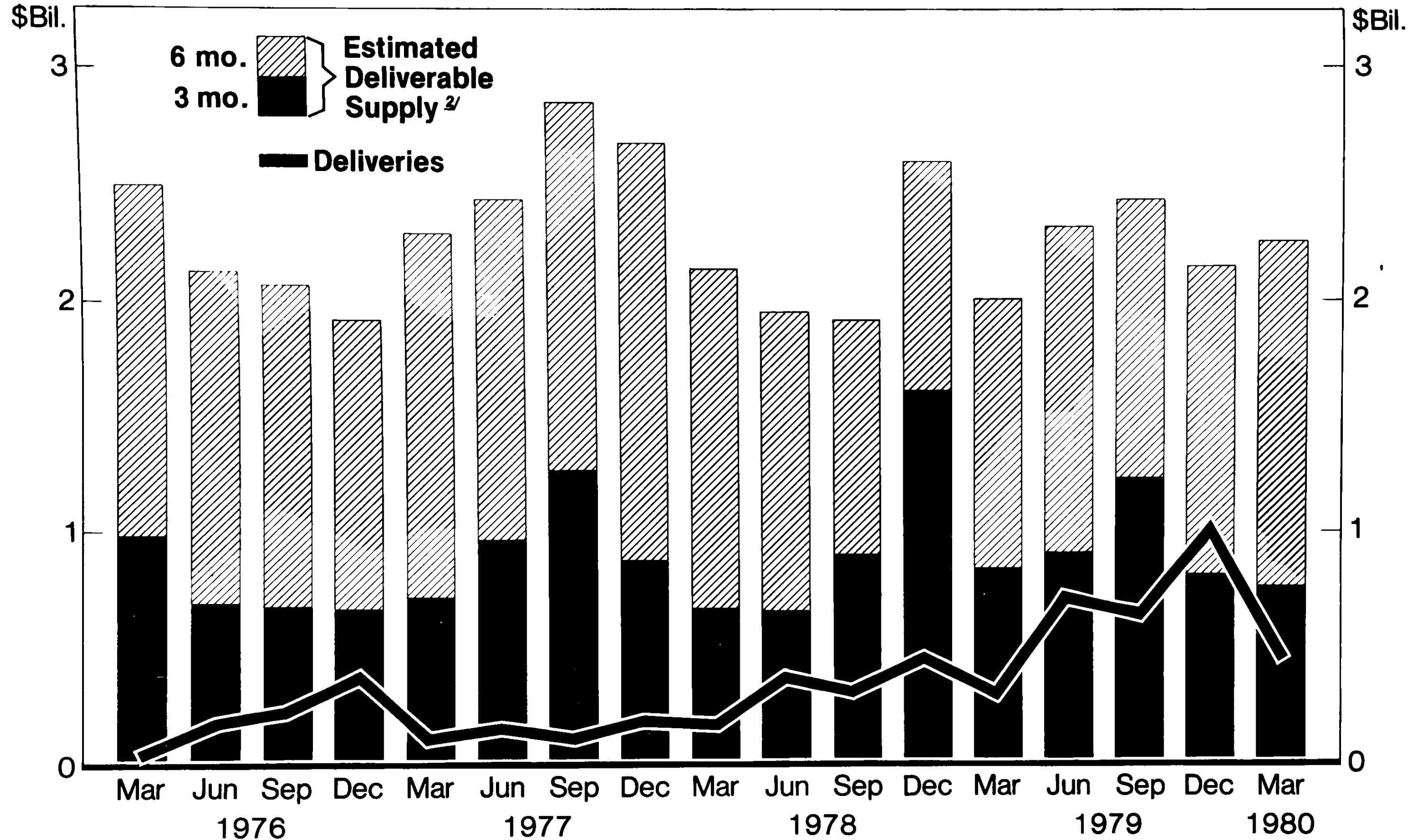
Office of Government Financing

April 29, 1980-13

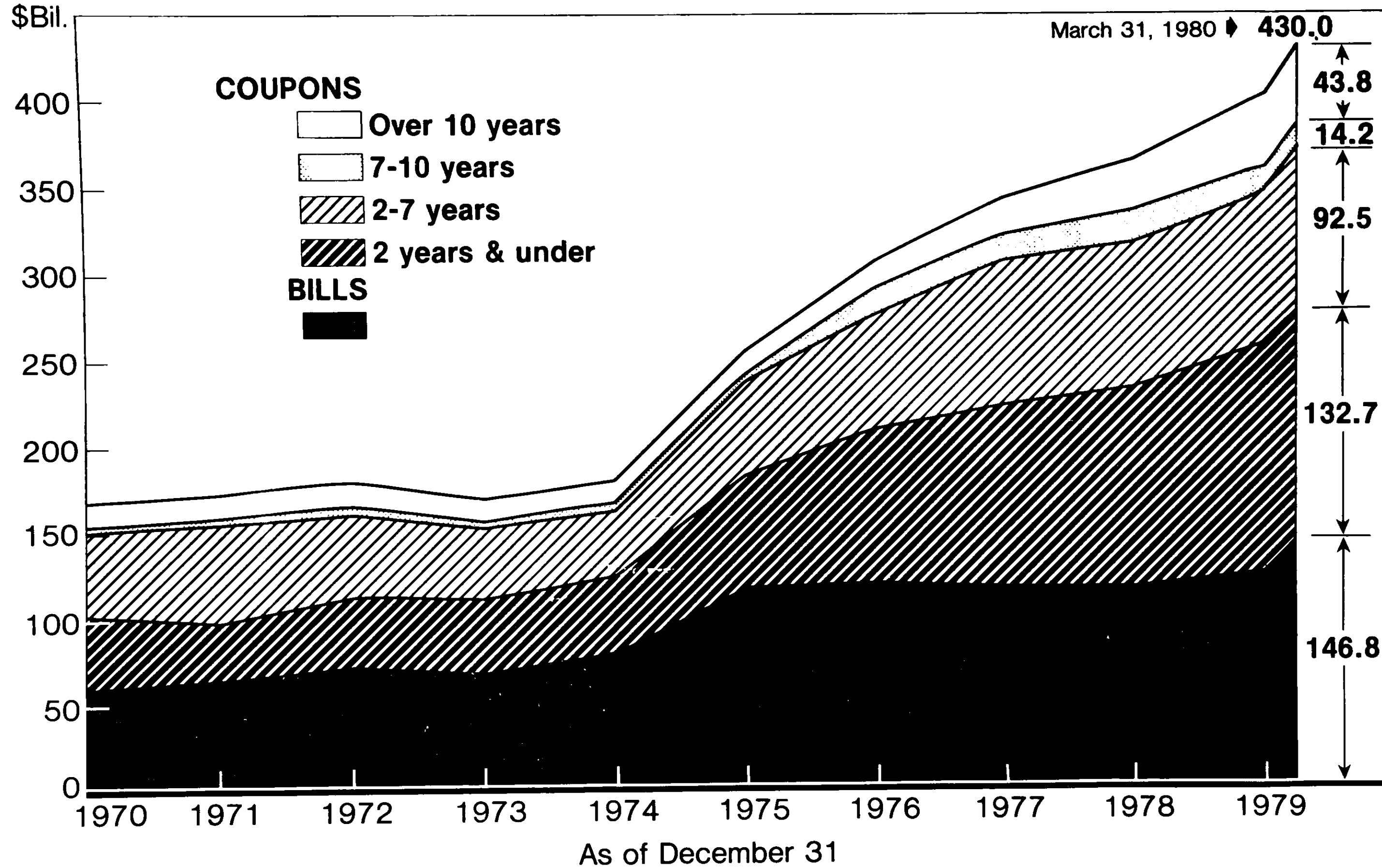
DELIVERABLE BILLS AND DELIVERIES ON 90 DAY TREASURY BILL FUTURES CONTRACTS [1]



[1] Contracts traded on the International Monetary Market (IMM).

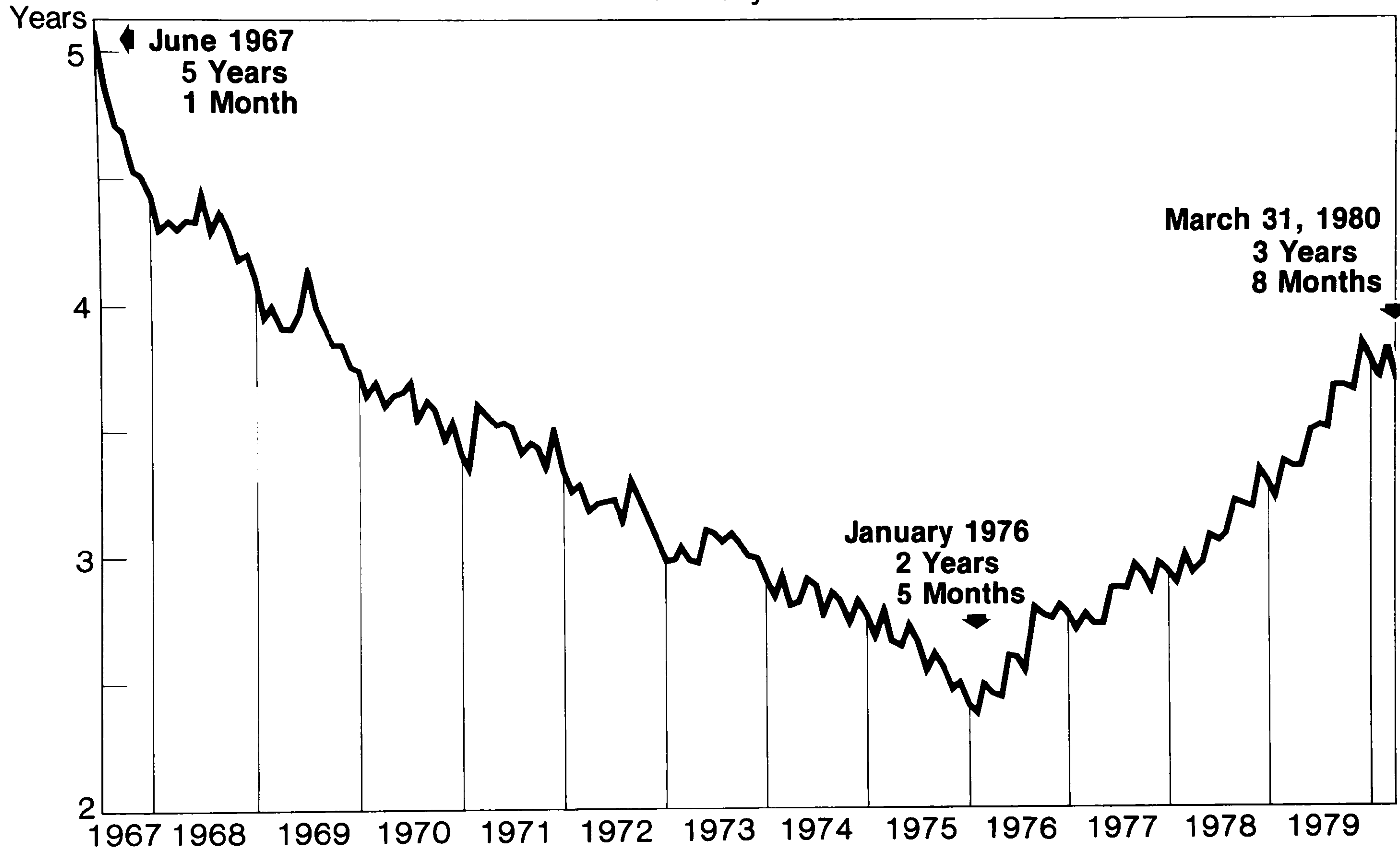
[2] Consists of the amount of accepted competitive tenders for the new 3 month bill and the 6 month bill issued 3 months earlier.

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT BY MATURITY



AVERAGE LENGTH OF THE MARKETABLE DEBT

Privately Held



Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-12

OWNERSHIP OF MATURING COUPON ISSUES

May - September 1980[1]

(In Millions of Dollars)

Maturing Issues		Total Privately Held	Commercial Banks	Savings Institutions: Long-term 2/ Investors	Savings Institutions: Intermediate-term 3/ Investors	State & Local General Funds	Corporations	Other Private Domestic Holders	Foreign
6 7/8% Nt.	5-15-80	1,711	505	7	251	70	81	764	33
8% Nt.	5-31-80	2,864	681	20	156	132	66	1,025	784
7 5/8% Nt.	6-30-80	1,855	761	6	276	95	2	340	375
8 1/4% Nt.	6-30-80	3,523	653	14	182	258	62	1,355	999
8 1/2% Nt.	7-31-80	3,356	811	10	282	270	143	1,005	835
9% Nt.	8-15-80	1,612	440	4	81	28	22	1,037	—
6 3/4% Nt.	8-15-80	3,430	1,063	9	266	85	402	473	1,132
8 3/8% Nt.	8-31-80	3,034	785	40	210	248	52	852	847
6 7/8% Nt.	9-30-80	1,988	706	15	288	87	234	290	368
8 5/8% Nt.	9-30-80	3,181	868	9	201	107	237	775	984
TOTAL		26,554	7,273	134	2,193	1,380	1,301	7,916	6,357

1/ Amounts for investor classes are based on the February 1980 Treasury Ownership Survey.

2/ Includes State and local pension funds and life insurance companies.

3/ Includes casualty and liability insurance companies, mutual savings banks, savings and loan associations, and corporate pension trust funds.

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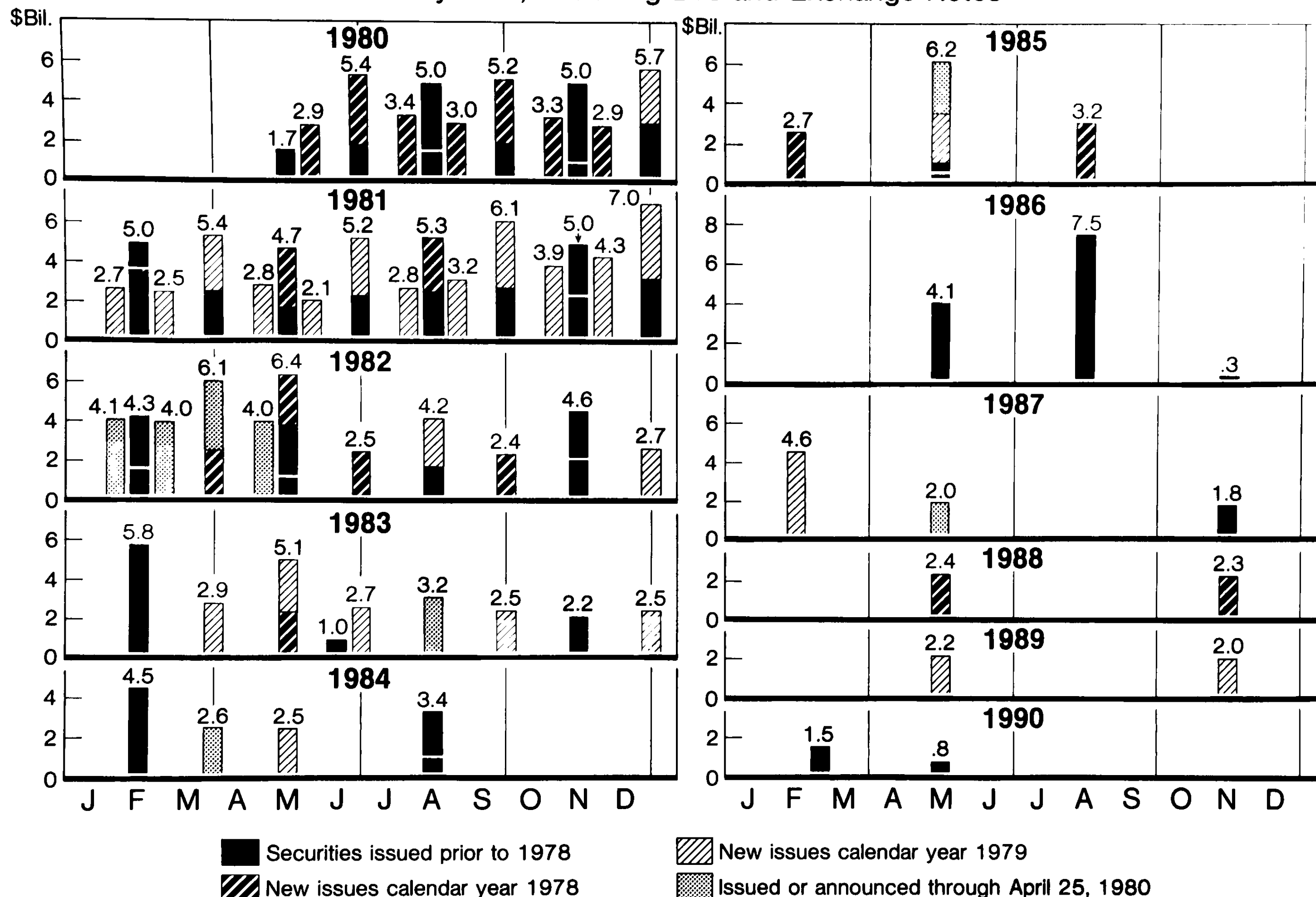
TREASURY MARKETABLE MATURITIES

Privately Held, Excluding Bills and Exchange Notes

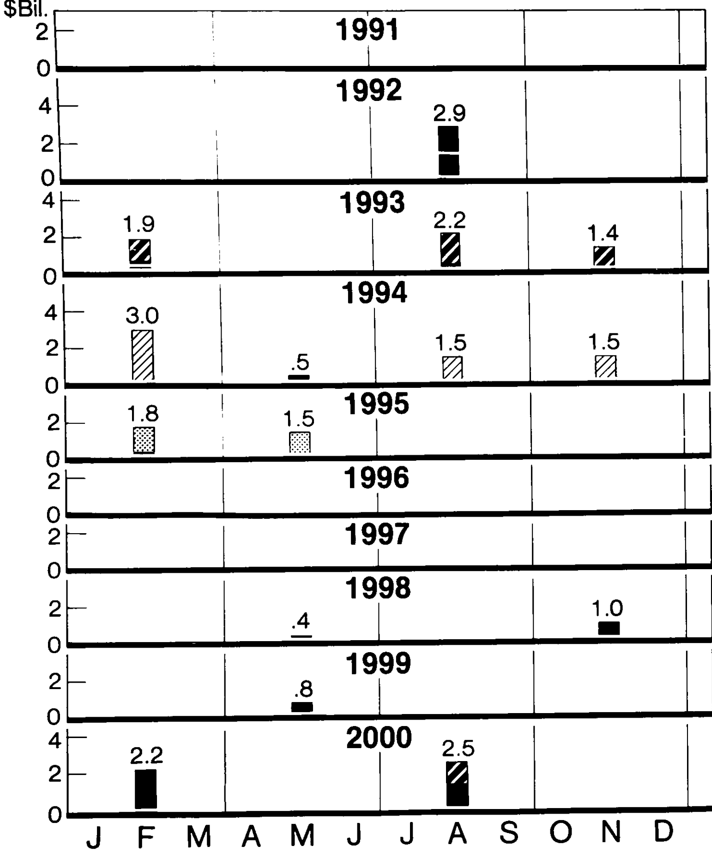


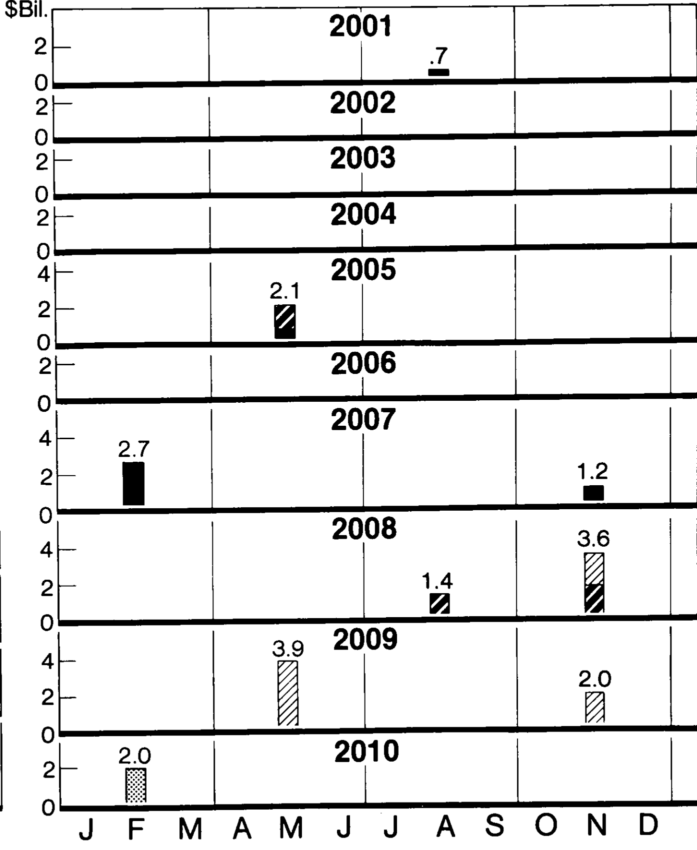
Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-17

TREASURY MARKETABLE MATURITIES

Privately Held, Excluding Bills and Exchange Notes





Securities issued prior to 1978

New issues calendar year 1978

New issues calendar year 1979

Issued or announced through April 25, 1980

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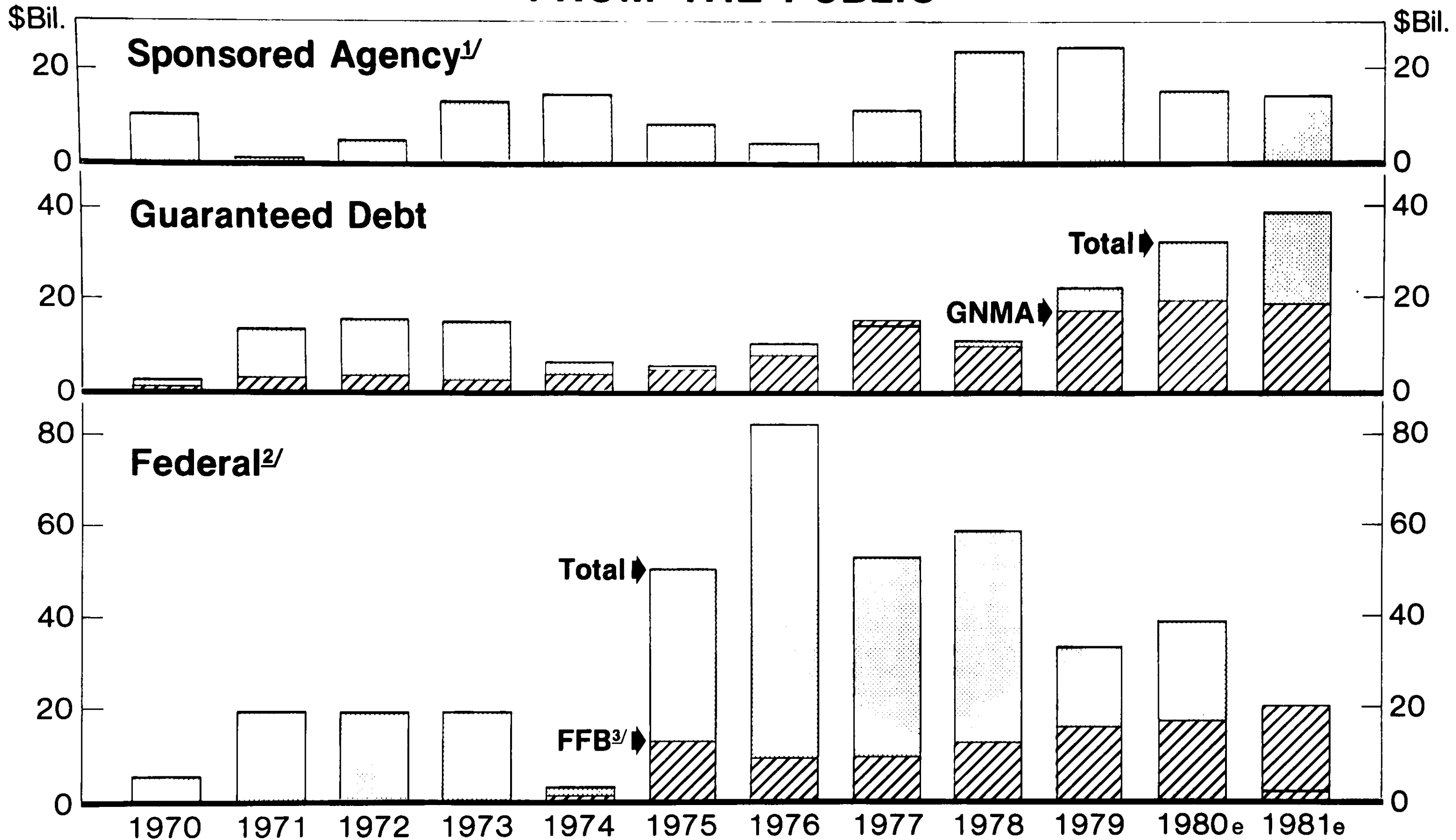
April 29, 1980-18



e - March 1980 Budget Revisions.

1/ Includes FNMA and FHLB and Farm Credit Systems.

2/ Includes Treasury debt and minor amounts of debt of other Federally-owned agencies.

3/ Federal Financing Bank borrowing from the Treasury.

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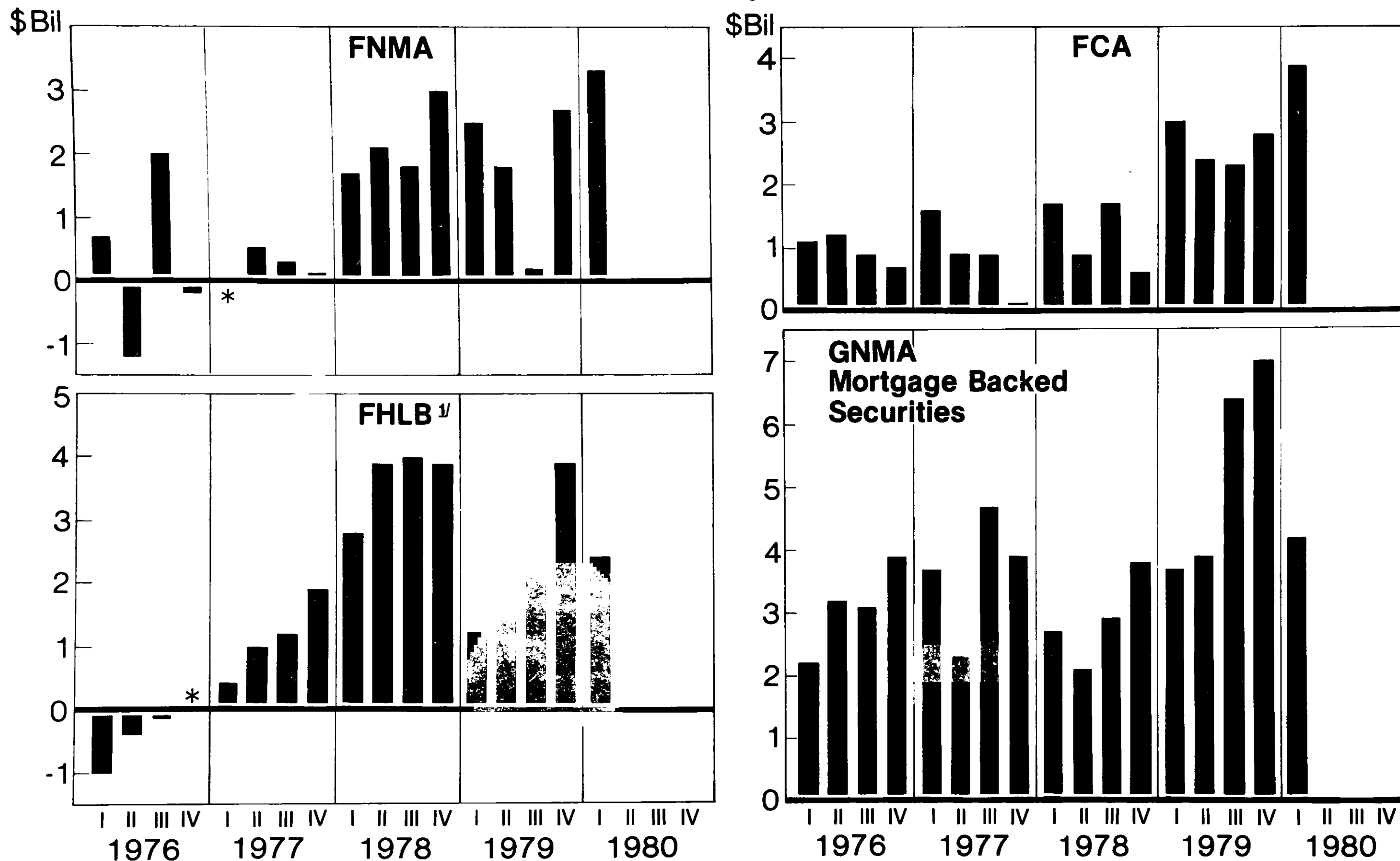
Office of Government Financing

April 29, 1980-23

NET NEW MONEY IN AGENCY FINANCE, QUARTERLY

Privately Held

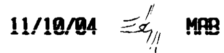


* Less than $50 million.

1/ Includes FHLB discount notes, bonds, and FHLMC certificates, mortgage-backed bonds, and mortgage participation certificates.

Office of the Secretary of the Treasury
Office of Government Financing

April 29, 1980-22



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11/10/04 MAB

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