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TREASURY DEPARTMENT

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-204

FOR IMMEDIATE RELEASE July 22, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,200 million of 13-week bills and for $7,230 million of 26-week bills, both to be issued on July 25, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing October 24, 1985			:	26-week bills maturing January 23, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.21%	7.45%	98.177	:	7.33%	7.72%	96.294
High	7.24%	7.48%	98.170	:	7.36%	7.75%	96.279
Average	7.23%	7.47%	98.172	:	7.35%	7.74%	96.284

Tenders at the high discount rate for the 13-week bills were allotted 47%.
Tenders at the high discount rate for the 26-week bills were allotted 52%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 51,385	$ 51,385	:	$ 47,475	$ 47,475
New York	16,324,880	6,018,285	:	17,262,955	6,074,795
Philadelphia	42,425	36,365	:	24,380	24,380
Cleveland	63,150	63,045	:	36,840	36,840
Richmond	46,550	46,550	:	52,340	47,340
Atlanta	55,260	47,610	:	50,680	42,080
Chicago	1,290,900	333,220	:	1,104,945	174,285
St. Louis	97,715	56,915	:	71,305	51,305
Minneapolis	54,640	54,110	:	36,770	26,610
Kansas City	69,625	64,615	:	54,535	50,055
Dallas	44,055	34,055	:	32,775	22,775
San Francisco	1,012,760	80,760	:	1,231,400	273,840
Treasury	313,440	313,440	:	358,010	358,010
TOTALS	$19,466,785	$7,200,355	:	$20,364,410	$7,229,790
Type					
Competitive	$16,716,095	$4,449,665	:	$17,647,660	$4,513,040
Noncompetitive	1,195,985	1,195,985	:	1,105,420	1,105,420
Subtotal, Public	$17,912,080	$5,645,650	:	$18,753,080	$5,618,460
Federal Reserve	1,184,435	1,184,435	:	1,100,000	1,100,000
Foreign Official Institutions	370,270	370,270	:	511,330	511,330
TOTALS	$19,466,785	$7,200,355	:	$20,364,410	$7,229,790

An additional $35,130 thousand of 13-week bills and an additional $ 59,070 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

For Immediate Release July 22, 1985

James H. Lokey, Jr.

Associate Tax Legislative Counsel

Assistant Secretary for Tax Policy, Ronald A. Pearlman, today announced the appointment of James H. Lokey, Jr. as Associate Tax Legislative Counsel. Mr. Lokey previously served as Acting Associate Tax Legislative Counsel and as an attorney-advisor in the Office of Tax Legislative Counsel.

As Associate Tax Legislative Counsel, Mr. Lokey, 32, reviews and assists in the development of tax regulations, rulings, and other tax policy matters. In addition, he participates in the development of the Treasury Department's recommendations for Federal tax legislation before Congressional Committees.

Prior to joining the Treasury Department, Mr. Lokey was in private practice with the law firm of Long & Aldridge in Atlanta, Georgia. Mr. Lokey is a graduate of Vanderbilt Law School, from which he received the J.D. degree in 1978, and a graduate of David Lipscomb College, from which he received a B.S. degree, magna cum laude, in 1974. At Vanderbilt he served as an editor of the Vanderbilt Law Review, was elected to the Order of the Coif, and received the Founder's Medal for First Honors.

Mr. Lokey, a native of Nashville, Tennessee, is a member of the State Bar of Georgia (admitted 1978) and the American Bar Association. He has lectured extensively on a wide variety of tax matters.

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TREASURY NEWS

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For Immediate Release July 22, 1985

David C. Garlock

Associate Tax Legislative Counsel

Assistant Secretary for Tax Policy, Ronald A. Pearlman, today announced the appointment of David C. Garlock as Associate Tax Legislative Counsel. Mr. Garlock had served as an Attorney-Advisor in the Office of Tax Policy since October 1982.

As Associate Tax Legislative Counsel, Mr. Garlock, 32, will continue to play an active role in matters relating to the time value of money, the taxation of insurance companies, and the Federal estate, gift and generation-skipping transfer tax. One of Mr. Garlock's primary responsibilities will be the review and development of IRS rulings prior to their publication.

Before joining Treasury, Mr. Garlock was an associate in the law firm of Roberts & Holland in New York. Mr. Garlock received the J.D. from Harvard Law School in 1979 and the A.B. from Harvard College in 1975.

Mr. Garlock is a member of the New York and District of Columbia Bars. He has authored a number of scholarly articles and has lectured extensively on a wide variety of tax matters.

Mr. Garlock, a native of Detroit, Michigan, is married to Barbara A. Schwartz and currently resides in Washington, D.C.

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TREASURY NEWS

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For Immediate Release July 22, 1985

Dennis E. Ross

Deputy Tax Legislative Counsel

Assistant Secretary for Tax Policy, Ronald A. Pearlman, today announced the appointment of Dennis E. Ross as Deputy Tax Legislative Counsel. Mr. Ross joined the Office of Tax Policy since in July, 1984 and has been Acting Deputy Tax Legislative Counsel since September, 1984.

As Deputy Tax Legislative Counsel, Mr. Ross, 34, supervises a staff of lawyers who review and assist in the development of tax regulations and rulings and participate in the preparation and presentation of the Treasury Department's recommendations for Federal tax legislation before Congressional committees.

Prior to joining Treasury, Mr. Ross was on the Faculty of the University of Michigan Law School and before that an Associate in the law firm of Davis Polk & Wardwell in New York. Mr. Ross received his J.D. from the University of Michigan Law School in 1978 and a B.A. in English from the University of Michigan in 1974.

Mr. Ross is a member of the New York State Bar.

Mr. Ross, a native of Chicago, Illinois, currently resides in Washington, D.C.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. July 23, 1985

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued August 1, 1985. This offering will provide about $ 450 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $ 13,959 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, July 29, 1985. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 7,200 million, representing an additional amount of bills dated November 1, 1984, and to mature October 31, 1985 (CUSIP No. 912794 HN 7), currently outstanding in the amount of $ 15,324 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 7,200 million, to be dated August 1, 1985, and to mature January 30, 1986 (CUSIP No. 912794 JQ 8).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing August 1, 1985. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,813 million as agents for foreign and international monetary authorities, and $2,243 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

For Release Upon Delivery
Expected at 9:30 a.m. EDT
Thursday, July 25, 1985

STATEMENT OF RONALD A. PEARLMAN
ASSISTANT SECRETARY
(TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE SENATE FINANCE COMMITTEE

Mr. Chairman and Members of the Committee:

I am pleased to appear before you today to discuss the treatment under the Federal income tax system of amounts paid for State and local taxes. As you know, the President's tax reform proposal would generally repeal the existing itemized deduction for State and local taxes.

Introduction

Current Law

Section 164 of the Internal Revenue Code allows taxpayers that itemize deductions to deduct four types of State and local taxes that are not incurred in a trade or business or income-seeking activity: individual income taxes, real property taxes, personal property taxes, and general sales taxes. Other State and local taxes are deductible by individuals only if they are incurred in carrying on a trade or business or income-seeking activity. This category includes taxes on gasoline, cigarettes, tobacco, alcoholic beverages, admission taxes, occupancy taxes and other miscellaneous taxes.

Taxes incurred in carrying on a trade or business or which are attributable to property held for production of rents or royalties (but not other income-producing property) are deductible in determining adjusted gross income. Thus, these taxes are deductible by both itemizing and nonitemizing taxpayers. Taxes incurred in carrying on other income-seeking activities are deductible only by individuals who itemize deductions. Examples of these taxes include real property taxes on vacant land held for investment and intangible personal

property taxes on stocks and bonds. State and local income taxes are not treated as incurred in carrying on a trade or business or as attributable to property held for the production of rents or royalties, and therefore are deductible only by individuals who itemize deductions.

Administration Proposal

Under the President's Tax Proposals to Congress for Fairness, Growth, and Simplicity, the itemized deduction for State and local income taxes and other taxes not incurred in carrying on a trade or business or income-seeking activity would be repealed. State and local taxes (other than income taxes) which currently are an itemized deduction but which are incurred in carrying on an income-seeking activity would be aggregated with certain other miscellaneous expenses and would be deductible above a threshhold of one percent of adjusted gross income.

State and local taxes that under current law are deductible without regard to whether the taxpayer itemizes would not be affected by the proposal. Thus, for example, real property taxes on property used in a trade or business or held for rental would remain deductible. Similarly, the proposal would not affect the deductibility of State and local taxes paid by corporations.

Reasons for Proposed Repeal

Fairness

Analysis of the deduction for State and local taxes appropriately begins with the question of its fairness in the context of the Federal income tax system. The question of fairness is, in turn, driven by the fact that States and localities vary significantly in the type and extent of public services which they choose to provide and thus in the level of State and local taxes they impose. Because of the deduction, differences in the level of taxes imposed by State and local governments translate to differences in the level of Federal income taxes paid by the residents of particular jurisdictions. The deduction thus leaves State and local governments with the ability to affect the Federal income tax liabilities of their residents through their own tax and spending policies. In net effect, the deduction causes a shift in Federal income tax burdens, with taxpayers in high-service, high-tax communities benefitting at the expense of taxpayers in low-service, low-tax communities. Put in other terms, because of the deduction, two itemizing taxpayers with equivalent incomes living in communities with different levels of State and local taxes will pay correspondingly different shares of the cost of national defense, interest on the national debt and other Federal programs. This result is patently unfair.

The unfair distribution of benefits among State and local jurisdictions as a result of the deduction for State and local taxes is illustrated by recent tax return data. As shown in Table 1, tax savings per capita in 1982 as a result of the deduction varied widely among the States, ranging from a high of $233 for New York to $20 for South Dakota. The discrepancies are even greater when the tax savings accruing to itemizers are compared. For example, in 1982, itemizing taxpayers in New York received an average tax savings of $1,292 from the deduction, whereas itemizers in Wyoming on average saved only $257.

Although the data in Table 1 focus on the distribution of the deduction's benefit among the States, it is important to recognize that the question of fairness is not simply a matter of high-tax versus low-tax States, but equally of high-tax versus low-tax communities within the same State. Thus, the deduction is of greater benefit to an affluent suburb with high property taxes, a population of high-income, itemizing taxpayers, and a high level of home ownership, than to a not far distant inner city community, where renters predominate and few itemize their deductions.

Tax return data also contradict those who argue that the deduction for State and local taxes is a "middle class deduction." Although a relatively large percentage of returns claim a deduction for State and local taxes, including 62% of taxable returns with AGI of between $25,000 and $30,000 (Table 2), the amount and value of the deduction reflects disproportionate use by high-income taxpayers. Thus, as shown in Table 3, roughly 75 percent of all taxable returns in 1983 had AGI of less than $30,000; however, this same group of returns accounted for only 28 percent of the total deductions taken for State and local taxes paid, and only 15 percent of the tax benefits from the deduction. Put another way, the top 25 percent of all taxable returns by AGI account for 85 percent of the total benefit from the taxes paid deduction.

A final issue of fairness concerns the effect of the deduction on State and local tax burdens within particular communities. Consider the variation in effective tax rates for three persons facing a 6 percent State sales tax: a nonitemizer, an itemizer in the 20 percent tax bracket, and an itemizer in the 50 percent bracket. The nonitemizer pays the full 6 percent sales tax rate, whereas the two itemizers pay effective rates of 4.8 and 3 percent, respectively. Thus, a State and local tax that is flat or even mildly progressive in form, is transformed by the deduction to one that is significantly regressive in effect.

Need to Reduce Marginal Rates

Aside from the issue of fairness, the revenues at stake with respect to the State and local tax deduction are critically important to our efforts to reduce marginal tax rates. Under current law, the deduction for State and local taxes is projected

to result in a revenue loss of approximately $33 billion in 1987, increasing to $40 billion by 1990. Unless these revenues are recaptured through a repeal of the State and local tax deduction, a significant reduction in marginal rates will not be possible within the constraint of revenue neutrality. We should not lose sight of the fact that lower tax rates are central to tax reform, and that lower rates will, in and of themselves, do much to reduce the significance of tax considerations in personal and commercial decision-making and therefore to promote fairness, growth, and simplicitly.

Inefficient Subsidy

Many who support the deduction for State and local taxes concede that it cannot be defended as a matter of tax policy, but argue instead that it is an appropriate subsidy for State and local government spending. Even assuming a Federal subsidy for State and local spending is appropriate, a subsidy provided through a deduction for State and local taxes fails on grounds both of efficiency and fairness. On average, State and local governments gain less than 50 cents for every dollar of Federal revenue loss because of the deduction. Moreover, a deduction for taxes does not distinguish between categories of State and local spending, but is as much a subsidy for spending on recreational facilities as for public welfare spending. The deduction thus operates as a general subsidy for State and local government spending, with the result that high-service, high-tax States and localities derive a disproportionate benefit.

Effect of Repeal on States and Localities

Effect on Spending

Many of the arguments for retention of the deduction for State and local taxes reflect concern over the effect of repeal on the ability of States and localities to raise necessary revenue. These concerns are understandable, but a hard look at the facts indicates that the effect of repeal on State and local spending will be extremely modest. Perhaps the most important fact to consider is that a relatively small percentage of State and local expenditures are financed with deductible taxes. As shown in Table 4, taxes claimed as an itemized deduction represent about 31 percent of all State and local tax revenues, and only 20 percent of all State and local revenue sources exclusive of borrowings.

Even as to State and local revenues derived from deductible taxes, the effect of repeal should be limited. Since the President's proposals are revenue neutral, State and local governments will face no greater competition with the Federal government for tax dollars. Indeed, among individuals, the only taxpayers affected by repeal of the State and local tax

deduction, the President's proposals reduce Federal income taxes, and thus leave even greater flexibility to State and local governments. In addition, the other base-broadening provisions contained in the Administration proposal will actually tend to increase tax revenue for the thirty-two States (and the District of Columbia) with income tax systems that utilize Federal concepts of taxable income. For example, Colorado recently estimated that, unless it lowered its income tax rates, 1986 tax revenues would be increased by $50 million as a result of the base-broadening contained in the Administration proposal. The proposed base-broadening will also benefit States that impose corporate income taxes that "piggyback" on Federal definitions of taxable income.

Our conclusion that repeal of the State and local tax deduction will have a very limited effect on State and local spending is confirmed by recent independent studies. Thus, a National League of Cities study found that total State and local spending is about two percent higher because of the existence of the deduction for State and local taxes. Similarly, a study by the Congressional Research Service predicted that total State and local expenditures would be only 1.5 percent lower if the deduction were repealed. Assuming that the current seven percent annual growth rate in State and local spending continues, these studies indicate that repeal of the deduction would not reduce the level of State and local spending, but would merely slow its rate of growth. Moreover, both of the studies assumed that nonitemizers exert no control over State and local spending and tax decisions. If the role of nonitemizers in the electoral process were taken into account, the predicted effect of repeal on State and local spending would necessarily be lower, perhaps by a substantial amount. The figures from the studies, of course, represent averages, and thus the effect on particular States and localities could be higher or lower.

It must also be recognized that repeal of the State and local tax deduction will reduce State and local spending only to the extent taxpayers decide that the services provided by State and local governments are not worth the taxes paid to provide them. Moreover, to whatever extent State and local taxpayers make that decision, the practical effect is not a loss of wealth to State and local communities, but a shift in resources from public to private activities. Thus, any loss in State and local government spending would be matched by an increase either in private goods or services or in private investment and savings. Such increase would have positive effects on State and local economies, which should, in turn, generate additional tax revenue.

Some opponents of repeal have argued that, at a minimum, the property tax deduction should be retained because of its importance in financing education expenditures. The argument ignores that itemized property taxes, the only property taxes that would be affected by the proposal, constitute only a small percentage of the revenues supporting public education

expenditures. Less than half of all State and local direct expenditures for elementary and secondary education are financed from property tax revenues. Moreover, less than 35% of all property taxes paid are claimed as an itemized deduction, with the balance either not deducted at all (because paid by non-itemizers) or deductible by corporations and other businesses and thus unaffected by repeal. Thus, less than 18% of all State and local direct expenditures for elementary and secondary education are financed by property taxes which are claimed as itemized deductions.

Effect on Interjurisdictional Tax Competition

Some opponents of repeal have argued that deductibility is necessary to mute tax competition among different jurisdictions, and that absent the deduction, State and local governments would bid destructively to attract taxpayers to their jurisdictions. Such fears about the adverse effects of tax competition are greatly overstated. Competition among business firms is universally heralded as the source of efficiency, innovation, and cost control; without it, consumers are at the mercy of those who enjoy monopoly positions. The same line of reasoning is applicable to competition among the States and among localities. As long as the Federal government mutes competition by picking up part of the tab for State and local expenditures, there is less need for responsive and responsible government. Competition can be expected to bring more innovative government, greater efficiency, and lower cost than a system in which State and local governments operate under the umbrella of Federal deductibility.

It should also be noted that taxes are but one element in the competition among jurisdictions. Jurisdictions that impose high taxes also deliver a high level of services. The choice faced by taxpayers is not simply whether to live in a high-tax or low-tax jurisdiction, but also whether to live in a jurisdiction with high or a low level of public services. Moreover, for the clear majority of taxpayers, those that do not itemize deductions, tax deductibility does not affect interjurisdictional tax differences.

Response to Arguments Against Repeal

Opponents of repeal of the deduction for State and local taxes have advanced a number of arguments in support of their position. We believe these arguments are without substance, and I would like to take this opportunity to respond to them.

1. "The Administration proposes repeal simply for the money." It has been asserted that the Administration proposes repeal of the State and local tax deduction simply "for the money." The assertion is not only untrue, it is disingenuous. Even a casual study of the academic literature would reveal that

economists and legal scholars have for years criticized the deduction for State and local taxes, and cited its repeal as an important element of tax reform. Similarly, the two leading tax reform proposals originated in Congress, one sponsored by Republicans and the other by Democrats, would each substantially restrict the State and local tax deduction. What these and other studies of tax reform have recognized is that the deduction for State and local taxes fails the basic test of fairness.

2. "The deduction is part of federalism." Some have argued that the disproportionate benefits provided to high-tax States by the deduction for State and local taxes are no different than the wide variety of direct benefits that the Federal government provides to State and local communities. On this view, the State and local tax deduction is akin to crop support, disaster relief, water and mass transit projects, and the other assorted Federal programs and benefits that are targetted to particular communities. Although this argument purports to draw on principles of federalism, it, in fact, confuses Federally coordinated programs that distribute benefits across the nation with a locally controlled subsidy for locally determined purposes. Imagine the response in Congress to a proposed Federal spending program under which State and local governments, each acting independent of the other as well as of the Federal government, were free to determine not only the programs on which funds were to be spent, but more critically, the actual level of spending. Such a proposal would surely not be taken seriously, and yet that is the precise effect of the deduction for State and local taxes. Unlike crop support, disaster relief and the other Federal projects that are annually reviewed and approved by Congress, the subsidy provided by the State and local tax deduction is controlled in both amount and character by the individual policies of countless State and local governments. Federalism is turned on its head if defined as a system under which taxpayers in low-tax States and localities are required to finance programs the size and purpose of which is determined solely by the taxpayers of high-tax States and localities.

3. "High-tax States put more into the Federal system than they get out." Some who defend the State and local tax deduction argue that even though high-tax States are disproportionately benefitted by the deduction, they nevertheless pay more on average to the Federal treasury in taxes than they receive in Federal outlays. Thus, so the argument goes, high-tax States are subsidizing low-tax States, rather than the reverse. This sort of argument verges on the irresponsibile, for it draws on a mechanical analysis of where Federal expenditures are made to support a conclusion about which States benefit from the expenditures. Consider Federal expenditures for national defense. Does the fact that an air force base is located in Colorado mean that the salaries of personnel at the base benefit no State in the Union other than Colorado? Similarly, does the cost of the ships, planes, missiles and other equipment used by

the armed services represent a benefit only to the State in which they are built? The answer, of course, is no; the benefit of Federal expenditures for defense, as with the great bulk of Federal expenditures generally, extends far beyond the State in which the expenditures are made.

There are comparable difficulties in allocating Federal tax receipts to particular States. Many individuals, particularly in the urban areas of the Northeast, work in one State but live in another. Which State should be credited with their tax payments? How, moreover, are corporate tax payments to be allocated among the States? Should they be treated as effectively paid by the corporation's customers, by its employees, by its shareholders, by all owners of capital, or by some combination thereof? The fact is that all of the published studies that have attempted to analyze the source of Federal tax revenues have been forced to make grossly simplifying assumptions about these and other questions. They are a slender ground on which to base an argument that some States pay more to the Federal government than they receive in benefits.

4. "State and local taxes have been deductible since the inception of the income tax." Some opponents of repeal have cited the fact that a deduction for State and local taxes has been allowed historically, as though to suggest that deductibility of State and local taxes is an inviolable tenet of Federal-State relations. A careful reading of the deduction's history, however, suggests something quite different. Although the first Civil War Income Tax Act and the Revenue Act of 1913 each allowed a deduction for State and local taxes, they similarly allowed a deduction for Federal taxes, including the Federal income tax itself. Over time, Congress increasingly narrowed the range of deductible taxes: the deduction for Federal income taxes was eliminated in 1917; the deduction for Federal and State inheritance and transfer taxes was eliminated in 1934; the deduction for certain State and local sales, transfer and admission taxes was eliminated in 1964; and the deduction for non-business State gasoline taxes was eliminated in 1978. The successive restrictions on deductible State and local taxes contradict any notion that the current deduction rests on a bedrock principle of federalism. Moreover, the historical grounds on which certain State and local taxes have remained deductible are of limited relevance today. For example, Congress in 1964 indicated that continued deductibility of State income taxes was appropriate because the combined Federal and State tax rate could otherwise be excessively high. That judgment may have been correct at a time when the maximum Federal rate was 90 percent, but there is no comparable basis for concern at current rates. Indeed, the reduction in Federal income tax rates under the President's proposals would generally reduce the combined rate of tax on individual and business income.

It should also be recognized that the early Federal income tax statutes were written at a time when the relative powers and responsibilities of the Federal and State governments were viewed much differently than today. In 1917, the Supreme Court was preparing to hold unconstitutional a Federal statute attempting to regulate child labor, Hammer v. Dagenhart, 247 U.S. 251 (1918), and was still decades away from recognizing Federal powers and responsibilities that are taken for granted today. This limited, and long since outmoded view of Federal authority carried over to the tax laws, where Congress originally allowed not only a deduction for State and local taxes, but also a complete exemption from tax for the salaries of State and local government employees. In time, it was recognized that whether State and local employees should pay Federal income tax was a question of tax and social policy, and not of Federal versus State authority. We believe the debate over the deductibility of State and local taxes should be conducted on the same terms, and that on those terms, the deduction is revealed as an anachronism that should be ended.

5. "Tax reform should not be accomplished on the backs of States and localities." Some opponents of repeal have asserted that the State and local tax deduction has been unfairly singled out in the Administration's proposal. Thus, they claim that the revenue loss from the State and local tax deduction constitutes only 11 percent of the revenue loss from all "loopholes" in the system (as measured by the tax expenditure budget), but 67 percent of the revenue necessary to lower marginal rates under the Administration proposal. At the outset, we would note that the figure of 67 percent was apparently derived by dividing the $33.3 billion revenue pickup from repeal of deductibility in fiscal year 1987 by the $49.5 billion revenue loss from the proposed change in the rate schedule in the same year. This analysis overlooks the fact that the increase in the zero bracket amount and the increase in the personal exemption are integral parts of the rate reduction provided in the President's proposals. When these items are considered, the revenue generated by repeal of the State and local tax deduction constitutes about 35 percent of the revenue necessary to revise the rate structure in fiscal year 1987 and about 31 percent in fiscal year 1990.

We recognize that absent repeal or reduction of every preference on the tax expenditure budget, those items that are repealed or reduced will inevitably generate a disproportionate share of the revenue necessary for rate reduction. This mathematical fact should not be permitted, however, to divert attention from the merits of particular preferences. In the context of fundamental tax reform, each preference must be tested separately for whether it is fair and in the national interest. We concluded, for example, that a deduction for charitable contributions should be retained, even though many would characterize it as a preference. The deduction for State and local taxes, however, should be judged on its own merits. If, as

we have concluded, it is neither fair nor in the national interest, it should be repealed.

6. "Repeal of the State and local tax deduction would amount to imposing a tax on a tax." We believe this argument is more rhetorical than real. It is contradicted by the practice of most States with respect to their own tax systems: 43 States and the District of Columbia impose a personal income tax, yet 28 of these jurisdictions do not permit a deduction for Federal income tax, and many also allow no deduction for local taxes. Similarly, of the 46 States that impose a corporate income tax, 39 do not permit a deduction for Federal income taxes.

To the extent the "tax on a tax" argument has substance beyond its rhetoric, it suggests that amounts paid in state and local taxes should be exempt from Federal taxation because such payments are involuntary and because State and local taxpayers receive nothing in return for their payments. Neither suggestion is correct. State and local taxpayers receive important personal benefits in return for their taxes, such as public education, water and sewer services, and municipal garbage removal. Moreover, State and local taxpayers have ultimate control over the taxes they pay through the electoral process and through their ability to locate in jurisdictions with amenable tax and fiscal policies.

7. "It's unfair to permit a foreign tax credit but not a State and local tax deduction." The asserted analogy between foreign taxes and State and local taxes is unsound. The foreign tax credit is an integral part of a system of international taxation in which primary taxing authority is generally ceded to the country where income is earned. Under this system, U.S. residents are allowed a foreign tax credit for foreign taxes paid, just as foreign taxpayers earning income in the U.S. are generally allowed a credit in their home country for U.S. taxes paid. In contrast to this international system in which primary taxing authority is ceded to one country, our federal system of government necessarily involves different levels of government applying tax to the same taxpayers and the same income. The deductibility of taxes paid to overlapping domestic jurisdictions thus is not an issue of double taxation but rather of the extent to which each jurisdiction is able to define its own tax base. As indicated above, most States assert this authority for themselves by denying a deduction for Federal income taxes.

Conclusion

Let me say in closing that the nation faces an historic opportunity to reform the tax system, for the benefit of ourselves and of generations to come. By reducing marginal tax rates and improving the fairness of the system we can remove unnecessary restraints on the prosperity of all Americans. We believe repeal of the deduction for State and local taxes is a necessary component of tax reform. Let me emphasize again that this is not simply a question of revenue, but more fundamentally,

a question of fairness. As has been eloquently stated by Governor Thornburgh "... what divides the nation is the unfairness of the present tax structure. If there's anything that demonstrates the unfairness of the deductibility of State and local taxes it's the fact that there's such an enormous difference in viewpoint depending on what State you're in .... When you have that kind of difference you've got an unfair tax system."

* * *

This concludes my prepared remarks. I would be happy to answer any questions that you might have at this time.

Table 1

States Ranked by Per Capita Tax Savings from Taxes Paid Deduction-- 1982

State	Tax Savings Per Capita	Income Per Capita	Rank of Income Per Capita
New York	$233	$12,314	7
District of Columbia	198	14,550	2
Maryland	185	12,238	9
New Jersey	167	13,089	4
Delaware	162	11,731	14
California	155	12,567	5
Massachusetts	155	12,088	11
Minnesota	150	11,175	19
Michigan	144	10,956	22
Wisconsin	137	10,774	26
Connecticut	135	13,748	3
Oregon	117	10,335	31
Hawaii	116	11,652	15
Rhode Island	116	10,723	28
Virginia	113	11,095	20
Colorado	110	12,302	8
U.S. Average	106	11,107	-
Illinois	101	12,100	10
Utah	91	8,875	46
Georgia	87	9,583	37
Nebraska	87	10,683	29
Oklahoma	89	11,370	18
Pennsylvania	83	10,955	23
Ohio	82	10,677	30
Kansas	80	11,765	13
North Carolina	77	10,044	41
Arizona	76	10,173	32
Iowa	75	10,791	25
Vermont	75	9,507	39
South Carolina	73	8,502	49
Maine	70	9,042	42
Missouri	70	10,170	34
New Hampshire	68	10,729	27
Kentucky	65	8,934	44
Idaho	64	9,029	43
Washington	63	11,560	16
Nevada	57	11,981	12
Indiana	51	10,021	35
Florida	50	10,978	21
Alabama	49	8,649	48
Arkansas	49	8,479	50
Alaska	45	16,257	1
Texas	43	11,419	17
North Dakota	42	10,872	24
Montana	41	9,580	38
Mississippi	39	7,778	51
New Mexico	38	9,190	40
West Virginia	34	8,769	47
Tennessee	33	8,906	45
Wyoming	33	12,372	6
Louisiana	31	10,231	32
South Dakota	20	9,666	36

Source: Advisory Commission on Intergovernmental Relations.

Table 2

Number and Percentage of Returns with Taxes Paid Deduction - 1983

Adjusted Gross Income Class	All Returns (thousands)	Taxable Returns (thousands)	Returns with Taxes Paid Deduction 1/ (thousands)	as percent of All Returns	as percent of Taxable Returns
Total	96,321	81,492	34,794	36.1%	42.7%
Under $ 5,000	17,836	5,806	538	3.0%	9.3%
$ 5,000 - $ 9,999	16,828	14,615	1,680	10.0%	11.5%
$ 10,000 - $ 14,999	13,878	13,523	2,621	18.9%	19.4%
$ 15,000 - $ 19,999	10,770	10,672	3,420	31.8%	32.0%
$ 20,000 - $ 24,999	8,848	8,802	4,166	47.1%	47.3%
$ 25,000 - $ 29,999	7,357	7,329	4,591	62.4%	62.6%
$ 30,000 - $ 39,999	10,421	10,389	8,140	78.1%	78.4%
$ 40,000 - $ 49,999	5,148	5,136	4,651	90.3%	90.6%
$ 50,000 - $ 74,999	3,591	3,582	3,393	94.5%	94.7%
$ 75,000 - $ 99,999	823	821	792	96.2%	96.5%
$ 100,000 - $ 199,999	622	620	607	97.6%	97.9%
$ 200,000 - $ 499,999	162	162	160	98.3%	98.5%
$ 500,000 - $ 999,999	25	25	25	98.6%	98.7%
$ 1,000,000 & over	11	11	11	98.5%	98.6%

Office of the Secretary of the Treasury
Office of Tax Analysis

July 23, 1985

1/ Taxes paid deduction net of State income tax refunds.

Note: Detail may not add to total because of rounding.

Source: Internal Revenue Service, Statistics of Income for 1983 individual income tax returns.

Table 3

Cumulative Percentages of Taxable Returns, Returns with Taxes Paid Deductions, Taxes Paid Deduction, and the Value of the Taxes Paid Deduction -- 1983

Adjusted Gross Income Class	Cumulative Percentages of:			
	Taxable Returns	Returns with Taxes Paid Deduction	Taxes Paid Deduction 1/	Value of Taxes Paid Deduction 2/
Under $ 5,000	7.12%	1.55%	.37%	**
Under $ 10,000	25.06%	6.38%	2.06%	.30%
Under $ 15,000	41.65%	13.91%	5.25%	1.43%
Under $ 20,000	54.75%	23.74%	10.45%	3.94%
Under $ 25,000	65.55%	35.71%	17.94%	8.27%
Under $ 30,000	74.54%	48.91%	28.04%	15.16%
Under $ 40,000	87.29%	72.30%	50.00%	33.17%
Under $ 50,000	93.59%	85.67%	66.00%	49.75%
Under $ 75,000	97.99%	95.42%	82.02%	70.14%
Under $ 100,000	99.00%	97.69%	87.41%	78.20%
Under $ 200,000	99.76%	99.44%	93.80%	88.93%
Under $ 500,000	99.96%	99.90%	97.18%	94.93%
Under $1,000,000	99.99%	99.97%	98.39%	97.11%
All Returns	100.00%	100.00%	100.00%	100.00%

Office of the Secretary of the Treasury
Office of Tax Analysis

July 24, 1985

1/ Taxes paid deduction net of State income tax refunds.

2/ The value of the deduction for taxes equals the marginal tax rate times the lesser of the deduction for taxes (net of State income tax refunds) or total itemized deductions (net of State income tax refunds) in excess of the zero bracket amount.

** Less than .005 percent.

Note: Detail may not add to total because of rounding.

Source: Internal Revenue Service, Statistics of Income for 1983 individual income tax returns.

Table 4

Taxes Paid Deductions as Percent of Total State and Local Government Receipts and Expenditures Calendar Year 1982

	$billions
Total itemized taxes paid deduction	$ 88.0
Minus State income tax refunds	5.0
Total taxes paid deductions net of refunds	83.0
Total tax revenue of State and local governments 1/	270.9
-- Itemized taxes paid deductions as percent	30.6
Total State and local government expenditures from own source revenues 2/	325.2
-- Itemized taxes paid deductions as percent	25.5
Total State and local government receipts from own source revenues 3/	358.0
-- Itemized taxes paid deductions as percent	23.2
Total State and local government expenditures after intergovernmental transfers 4/	409.0
-- Itemized taxes paid deductions as percent	20.3

Office of the Secretary of the Treasury
Office of Tax Analysis

July 22, 1985

1/ Fiscal year data converted to calendar year with 3/4 for FY 82 and 1/4 for FY 83.

2/ Excludes the $81.6 billion of Federal aid to State and local governments.

3/ Includes interest earnings, user fees and miscellaneous charges.

4/ Federal aid to State and local governments spent by State and local governments as State and local expenditures.

Source: Statistics of Income Individual Income Tax Returns 1982; Advisory Commission on Intergovernmental Affairs, Significant Features of Fiscal Federalism, Tables 1, 2, 3, and 33.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-204

FOR IMMEDIATE RELEASE July 24, 1985

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $9,264 million of $18,348 million of tenders received from the public for the 2-year notes, Series X-1987, auctioned today. The notes will be issued July 31, 1985, and mature July 31, 1987.

The interest rate on the notes will be 8-7/8%. The range of accepted competitive bids, and the corresponding prices at the 8-7/8% interest rate are as follows:

	Yield	Price
Low	8.94%	99.883
High	9.00%	99.776
Average	8.98%	99.812

Tenders at the high yield were allotted 50%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 63,860	$ 62,860
New York	15,363,445	7,639,445
Philadelphia	40,420	40,420
Cleveland	200,410	195,410
Richmond	105,390	102,890
Atlanta	91,590	83,090
Chicago	1,088,505	506,505
St. Louis	113,290	95,290
Minneapolis	68,260	67,260
Kansas City	161,900	160,150
Dallas	28,525	28,525
San Francisco	1,014,580	274,580
Treasury	7,340	7,340
Totals	$18,347,515	$9,263,765

The $9,264 million of accepted tenders includes $1,087 million of noncompetitive tenders and $8,177 million of competitive tenders from the public.

In addition to the $9,264 million of tenders accepted in the auction process, $330 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $479 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

federal financing bank NEWS
WASHINGTON, D.C. 20220
Press 566-2041
FFB 566-2468

FOR IMMEDIATE RELEASE July 25, 1985

FEDERAL FINANCING BANK ACTIVITY

Francis X. Cavanaugh, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of June 1985.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $151.6 billion on June 30, 1985, posting an increase of $2.0 billion from the level on May 31, 1985. This net change was the result of increases in holdings of agency assets of $1.1 billion, holdings of agency-guaranteed debt of $0.6 billion and holdings of agency debt of $0.3 billion during the month. FFB made 290 disbursements during June.

Attached to this release are tables presenting FFB June loan activity, new FFB commitments entered during June and FFB holdings as of June 30, 1985.

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FEDERAL FINANCING BANK

JUNE 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
ON-BUDGET AGENCY DEBT					
TENNESSEE VALLEY AUTHORITY					
Advance #473	6/1	$ 299,000,000.00	6/6/85	7.495%	
Advance #474	6/3	232,000,000.00	6/10/85	7.495%	
Advance #475	6/6	375,000,000.00	6/13/85	7.265%	
Advance #476	6/10	358,000,000.00	6/17/85	8.945%	
Advance #477	6/13	366,000,000.00	6/20/85	7.445%	
Advance #478	6/17	341,000,000.00	6/24/85	7.025%	
Advance #479	6/20	365,000,000.00	6/28/85	7.075%	
Advance #480	6/24	65,000,000.00	7/1/85	7.385%	
Advance #481	6/24	262,000,000.00	7/2/85	7.385%	
Advance #482	6/28	200,000,000.00	7/8/85	7.245%	
Advance #483	6/28	227,000,000.00	7/2/85	7.245%	
Advance #484	6/29	159,000,000.00	7/8/85	7.165%	
Advance #485	6/30	92,000,000.00	7/8/85	7.165%	
EXPORT-IMPORT BANK					
Note #64	6/3	456,000,000.00	6/1/95	10.405%	10.273% qtr.
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
+Note #332	6/3	5,000,000.00	9/3/85	7.505%	
+Note #333	6/10	900,000.00	9/3/85	7.505%	
+Note #334	6/10	3,000,000.00	9/9/85	7.515%	
+Note #335	6/11	9,850,000.00	9/9/85	7.595%	
+Note #336	6/18	20,000,000.00	9/16/85	7.115%	
AGENCY ASSETS					
FARMERS HOME ADMINISTRATION					
Certificates of Beneficial Ownership					
	6/1	20,000,000.00	6/1/05	10.825%	11.118% ann.
	6/2	150,000,000.00	6/1/95	10.405%	10.676% ann.
	6/17	120,000,000.00	6/1/95	10.095%	10.350% ann.
	6/25	50,000,000.00	6/1/95	10.565%	10.844% ann.
	6/30	435,000,000.00	6/1/95	10.375%	10.644% ann.
	6/30	100,000,000.00	6/1/00	10.545%	10.823% ann.
	6/30	120,000,000.00	6/1/05	10.725%	11.013% ann.
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Egypt 7	6/3	104,454,462.37	7/31/14	10.499%	
Greece 15	6/3	12,330,320.00	6/15/12	10.509%	
Korea 19	6/3	747,773.05	6/30/96	10.275%	
Egypt 6	6/4	1,595,952.96	4/15/14	10.565%	
Philippines 10	6/4	278,253.85	7/15/92	9.595%	
Morocco 11	6/4	72,779.49	9/8/95	10.175%	
Honduras 7	6/5	113,029.76	9/25/91	9.895%	
Egypt 7	6/6	1,178,803.25	7/31/14	10.165%	
Indonesia 10	6/6	1,685,474.22	3/20/93	8.806%	
Greece 15	6/7	1,331,544.00	6/15/12	10.095%	
Korea 19	6/7	4,520,000.00	6/30/96	9.972%	
Spain 5	6/7	923,741.30	6/15/91	9.506%	
Spain 7	6/7	7,612,428.00	7/15/95	10.015%	

+rollover

FEDERAL FINANCING BANK

JUNE 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
Foreign Military Sales (Cont'd)					
Greece 14	6/10	$ 633,520.95	4/30/11	10.725%	
Greece 15	6/10	3,056,564.88	6/15/12	10.351%	
Zaire 2	6/10	4,129,654.00	9/22/93	9.750%	
Spain 5	6/11	570,660.70	6/15/91	9.885%	
Spain 7	6/11	6,417,255.45	7/15/95	10.295%	
Spain 8	6/11	570,400.33	3/25/96	9.105%	
Turkey 13	6/11	727,158.22	3/24/12	10.665%	
Egypt 7	6/13	19,042,539.66	7/31/14	10.424%	
Thailand 10	6/14	3,960,895.88	7/10/94	10.325%	
Thailand 11	6/14	15,467,395.00	9/10/95	10.229%	
Tunisia 16	6/18	5,268,603.88	2/4/96	10.107%	
Korea 19	6/18	1,283,500.00	6/30/96	10.055%	
Egypt 7	6/18	6,429,078.98	7/31/14	10.264%	
Botswana 2	6/18	24,600.00	1/15/88	7.425%	
Lebanon 7	6/19	25,230,112.47	7/25/91	9.476%	
Peru 9	6/19	75,250.00	9/15/95	9.805%	
Philippines 10	6/19	2,548,405.93	7/15/92	9.459%	
Spain 8	6/19	4,672,351.83	3/25/96	8.595%	
Greece 14	6/20	44,446.80	4/30/11	10.585%	
Egypt 6	6/20	1,129,804.10	4/15/14	10.535%	
El Salvador 7	6/20	804,364.44	6/10/96	10.165%	
Botswana 4	6/21	15,655.71	7/25/92	7.525%	
Morocco 9	6/21	260,024.00	3/31/94	10.215%	
Morocco 11	6/21	1,745.00	9/8/95	10.255%	
Morocco 12	6/21	7,920.05	9/21/95	10.245%	
Morocco 13	6/21	1,088,577.56	5/31/96	9.856%	
Turkey 13	6/21	4,446,950.82	3/24/12	10.639%	
Egypt 7	6/24	20,490,567.77	7/31/14	10.699%	
Greece 15	6/24	1,338,035.53	6/15/12	10.575%	
Ecuador 5	6/25	131,290.50	5/25/88	9.335%	
Ecuador 8	6/25	391,185.00	7/31/96	9.877%	
Jordan 10	6/25	4,140.68	3/10/92	7.905%	
Jordan 11	6/25	17,270.00	11/15/92	9.145%	
Korea 19	6/27	50,426,930.71	6/30/96	10.648%	
Philippines 10	6/27	131,723.07	7/15/92	10.105%	
Thailand 11	6/27	11,433,865.00	9/10/95	10.610%	
Zaire 1	6/28	16,781.03	9/22/92	10.395%	
Zaire 2	6/28	679,954.00	9/22/93	10.433%	
Zaire 3	6/28	6,777,925.29	9/15/94	10.124%	
DEPARTMENT OF ENERGY					
Synthetic Fuels - Non-Nuclear Act					
Great Plains Gasification Assoc. #136	6/12	5,500,000.00	1/2/86	8.635%	
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT					
Community Development					
Inglewood, CA	6/6	1,226,488.57	8/1/86	7.905%	8.061% ann.
Council Bluffs, IO	6/7	150,572.00	5/31/86	7.835%	7.985% ann.
Newport News, VA	6/11	192,000.00	2/15/86	7.955%	8.038% ann.
Ponce, PR	6/11	140,560.00	8/1/85	7.585%	
Provo, UT	6/11	408,767.00	8/1/85	7.585%	
Elizabeth, NJ	6/12	94,150.00	12/31/85	7.765%	7.792% ann.
Newburgh, NY	6/12	255,000.00	8/1/85	7.445%	
Birmingham, AL	6/17	500,000.00	9/1/03	10.214%	10.475% ann.
Savannah, GA	6/17	700,000.00	8/1/86	7.745%	7.895% ann.
Louisville, KY	6/17	2,150,000.00	2/1/86	7.385%	7.439% ann.
*Kansas City, MO	6/17	3,000,000.00	6/15/90	9.077%	9.283% ann.
Lynn, MA	6/18	132,047.05	8/15/85	7.105%	

*maturity extension

FEDERAL FINANCING BANK

JUNE 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
Community Development (Cont'd)					
Long Beach, CA	6/18	$ 31,000.00	8/1/85	7.105%	
Dade County, FL	6/27	145,000.00	7/15/85	7.335%	
DEPARTMENT OF THE NAVY					
Ship Lease Financing					
Williams	6/6	112,961,000.00	7/15/85	7.265%	
Williams	6/6	63,200,359.00	6/27/85	7.265%	
+Pless	6/7	54,080,510.74	6/12/85	7.325%	
Buck	6/7	45,000,000.00	7/15/85	7.325%	
Buck	6/7	23,290,000.00	7/15/85	7.325%	
+Bobo Container	6/7	2,200,359.00	7/15/85	7.325%	
+Pless	6/7	2,919,489.26	7/15/85	7.325%	
+Pless Container	6/12	2,330,000.00	7/15/85	7.505%	
+Pless	6/12	5,750,510.74	6/13/85	7.505%	
+Williams	6/27	63,200,359.00	7/9/85	7.335%	
RURAL ELECTRIFICATION ADMINISTRATION					
S. Mississippi Electric #288	6/3	5,000,000.00	12/31/15	10.709%	10.569% qtr.
Corn Belt Power #292	6/3	370,000.00	6/30/87	9.065%	8.965% qtr.
Saluda River Electric #271	6/3	3,285,000.00	6/30/87	9.065%	8.965% qtr.
*S. Mississippi Electric #90	6/3	3,945,000.00	6/30/87	9.043%	8.943% qtr.
*Kansas Electric #216	6/3	1,330,000.00	1/2/18	10.718%	10.578% qtr.
*Minnkota Power #102	6/3	3,791,000.00	12/31/12	10.708%	10.568% qtr.
Sho-Me Power #164	6/4	650,000.00	6/4/87	8.845%	8.749% qtr.
N.W. Electric #176	6/4	600,000.00	6/4/87	8.845%	8.749% qtr.
Basin Electric #232	6/5	15,000,000.00	12/3/85	7.625%	7.560% qtr.
*Wolverine Power #183	6/5	7,519,000.00	6/6/88	9.145%	9.043% qtr.
*Wolverine Power #191	6/5	821,000.00	6/6/88	9.145%	9.043% qtr.
*Sunflower Electric #174	6/7	15,000,000.00	6/7/87	8.625%	8.534% qtr.
*Wabash Valley Power #104	6/10	5,559,000.00	6/10/87	8.945%	8.847% qtr.
*Wabash Valley Power #206	6/10	6,870,000.00	6/10/87	8.945%	8.847% qtr.
*Wolverine Power #182	6/10	2,134,000.00	6/10/88	9.275%	9.170% qtr.
*Wolverine Power #183	6/10	2,796,000.00	6/10/88	9.275%	9.170% qtr.
*Wolverine Power #233	6/10	7,793,000.00	6/10/87	8.945%	8.847% qtr.
*Wolverine Power #234	6/10	893,000.00	6/10/87	8.945%	8.847% qtr.
*Sunflower Electric #174	6/10	8,540,000.00	6/10/87	8.945%	8.847% qtr.
*Colorado Ute Electric #78	6/11	1,063,000.00	6/30/87	8.995%	8.896% qtr.
*Cajun Electric #197	6/12	22,000,000.00	6/13/88	9.275%	9.170% qtr.
*Cajun Electric #249	6/12	20,000,000.00	12/31/19	10.536%	10.401% qtr.
*Plains Electric #158	6/13	5,536,000.00	12/31/17	10.587%	10.450% qtr.
*Plains Electric #158	6/13	5,170,000.00	12/31/17	10.588%	10.451% qtr.
Tri-State G&T #250	6/14	5,286,000.00	12/31/19	10.640%	10.502% qtr.
Deseret G&T #211	6/14	7,951,000.00	6/15/87	8.885%	8.788% qtr.
Plains Electric #300	6/17	12,500,000.00	1/3/17	10.288%	10.159% qtr.
*Allegheny Electric #93	6/17	4,744,000.00	12/31/13	10.266%	10.138% qtr.
*Allegheny Electric #93	6/17	4,548,000.00	12/31/13	10.266%	10.138% qtr.
*Allegheny Electric #93	6/17	3,329,000.00	12/31/13	10.266%	10.138% qtr.
*Allegheny Electric #93	6/17	1,411,000.00	12/31/13	10.266%	10.138% qtr.
*Allegheny Electric #255	6/17	3,058,000.00	1/2/18	10.431%	10.298% qtr.
*Allegheny Electric #255	6/17	4,627,000.00	1/2/18	10.431%	10.298% qtr.
*Allegheny Electric #255	6/17	4,520,000.00	1/2/18	10.431%	10.298% qtr.
*New Hampshire Electric #192	6/17	1,070,000.00	12/31/17	10.431%	10.298% qtr.
*Oglethorpe Power #74	6/17	7,379,000.00	12/31/15	10.424%	10.292% qtr.
*Oglethorpe Power #150	6/17	25,003,000.00	12/31/15	10.424%	10.292% qtr.
*Oglethorpe Power #246	6/17	73,526,000.00	12/31/17	10.431%	10.298% qtr.
*Wabash Valley Power #252	6/17	2,115,000.00	12/31/17	10.431%	10.298% qtr.
*Cooperative Power #130	6/17	5,000,000.00	6/17/87	8.575%	8.485% qtr.
*Wolverine Power #190	6/18	4,092,000.00	6/20/88	8.995%	8.896% qtr.
*East Kentucky Power #188	6/18	5,800,000.00	12/31/15	10.403%	10.271% qtr.
*East Kentucky Power #188	6/18	10,110,000.00	12/31/15	10.403%	10.271% qtr.
Plains Electric #158	6/18	15,000,000.00	12/31/15	10.403%	10.271% qtr.

+rollover
*maturity extension

FEDERAL FINANCING BANK

JUNE 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd)					
Plains Electric #158	6/18	$ 16,022,000.00	12/31/15	10.403%	10.271% qtr.
Plains Electric #158	6/18	3,606,000.00	1/2/18	10.408%	10.276% qtr.
Plains Electric #158	6/18	9,826,000.00	1/2/18	10.408%	10.276% qtr.
Plains Electric #158	6/18	9,904,000.00	1/2/18	10.408%	10.276% qtr.
Allegheny Electric #255	6/19	1,132,000.00	12/31/19	10.363%	10.232% qtr.
New Hampshire Electric #270	6/19	401,000.00	12/31/17	10.361%	10.230% qtr.
Kepco #282	6/20	898,000.00	12/31/15	10.484%	10.350% qtr.
Oglethorpe Power #246	6/21	55,179,000.00	12/31/19	10.577%	10.441% qtr.
Western Farmers Electric #196	6/21	589,000.00	6/21/87	8.715%	8.622% qtr.
Plains Electric #158	6/21	47,000,000.00	12/31/15	10.573%	10.437% qtr.
*S. Mississippi Electric #3	6/24	5,000.00	12/31/10	10.578%	10.442% qtr.
*S. Mississippi Electric #3	6/24	679,000.00	12/31/12	10.597%	10.460% qtr.
*S. Mississippi Electric #90	6/24	464,000.00	12/31/12	10.597%	10.460% qtr.
*Wabash Valley Power #252	6/24	2,000,000.00	12/31/16	10.734%	10.594% qtr.
East Kentucky Power #140	6/24	720,000.00	12/31/19	10.727%	10.587% qtr.
East Kentucky Power #291	6/24	215,000.00	12/31/15	10.730%	10.590% qtr.
South Texas Electric #200	6/24	515,000.00	12/31/19	10.727%	10.587% qtr.
Brazos Electric #230	6/25	2,826,000.00	12/31/19	10.800%	10.658% qtr.
Corn Belt Power #292	6/25	306,000.00	1/2/18	10.799%	10.657% qtr.
*United Power #67	6/25	600,000.00	6/25/88	9.385%	9.277% qtr.
*United Power #129	6/25	15,530,000.00	6/25/88	9.385%	9.277% qtr.
North Carolina Electric #268	6/27	8,079,000.00	6/30/87	9.075%	8.974% qtr.
Vermont Electric #259	6/28	1,833,000.00	12/31/19	10.706%	10.566% qtr.
Kamo Electric #148	6/28	548,000.00	6/30/87	8.935%	8.837% qtr.
Kamo Electric #209	6/28	2,097,000.00	6/30/87	8.935%	8.837% qtr.
Kamo Electric #266	6/28	3,519,000.00	6/30/87	8.924%	8.827% qtr.
Basin Electric #232	6/28	30,000,000.00	12/3/85	7.485%	7.427% qtr.
Basin Electric #272	6/28	579,000.00	6/30/87	8.917%	8.820% qtr.
*Colorado Ute Electric #168	6/28	868,656.00	6/29/87	8.935%	8.837% qtr.
*Colorado Ute Electric #203	6/28	1,712,000.00	6/29/87	8.935%	8.837% qtr.
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
St. Louis L. D. Company	6/5	17,000.00	6/1/00	10.161%	
Scioto Econ. Dev. Corp.	6/5	24,000.00	6/1/00	10.161%	
Mahoning Valley Ec. Dev. Corp.	6/5	67,000.00	6/1/00	10.161%	
F.P.S. Dev. Assoc.	6/5	67,000.00	6/1/00	10.161%	
Small Bus. Scvs., Inc.	6/5	69,000.00	6/1/00	10.161%	
St. Louis County L.D.C.	6/5	105,000.00	6/1/00	10.161%	
Chester County S.B.A. Corp.	6/5	116,000.00	6/1/00	10.161%	
Gr. Bakersfield L.D.C.	6/5	116,000.00	6/1/00	10.161%	
Kisatchie Delta RP&D Dis., Inc.	6/5	119,000.00	6/1/00	10.161%	
St. Louis County L.D.C.	6/5	142,000.00	6/1/00	10.161%	
Jefferson County L.D.C.	6/5	145,000.00	6/1/00	10.161%	
Community E.D.C. of Colorado	6/5	273,000.00	6/1/00	10.161%	
Urban County Com. Dev. Corp.	6/5	286,000.00	6/1/00	10.161%	
Georgia Mountains R.E.D. Corp.	6/5	329,000.00	6/1/00	10.161%	
Black Hawk County E.D.C., Inc.	6/5	500,000.00	6/1/00	10.161%	
Hamilton County Dev. Co., Inc.	6/5	500,000.00	6/1/00	10.161%	
Southwestern Penn Ec. Dev. Dis.	6/5	500,000.00	6/1/00	10.161%	
St. Louis L.D. Co.	6/5	45,000.00	6/1/05	10.382%	
Red Cedar C. D. C.	6/5	45,000.00	6/1/05	10.382%	
Texas Cert. Dev. Co., Inc.	6/5	49,000.00	6/1/05	10.382%	
Wilmington Ind. Dev., Inc.	6/5	57,000.00	6/1/05	10.382%	
St. Louis Local Dev. Corp.	6/5	63,000.00	6/1/05	10.382%	
Texas Cert. Dev. Co., Inc.	6/5	63,000.00	6/1/05	10.382%	
Mid-Atlantic C.D.C.	6/5	76,000.00	6/1/05	10.382%	
Commonwealth S.B.D. Corp.	6/5	84,000.00	6/1/05	10.382%	
Ec. Dev. Fdn. of Sacramento	6/5	85,000.00	6/1/05	10.382%	
Clay County Dev. Corp.	6/5	95,000.00	6/1/05	10.382%	
Lapeer Dev. Corp.	6/5	103,000.00	6/1/05	10.382%	
Econ Dev Corp of Shasta County	6/5	104,000.00	6/1/05	10.382%	

*maturity extension

FEDERAL FINANCING BANK

JUNE 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
State & Local Development Company Debentures (Cont'd)					
Altoona Enterprises, Inc.	6/5	$ 105,000.00	6/1/05	10.382%	
Kansas City Corp. of Ind. Dev.	6/5	105,000.00	6/1/05	10.382%	
San Diego County L.D. Corp.	6/5	107,000.00	6/1/05	10.382%	
Saint Paul 503 Dev. Co.	6/5	108,000.00	6/1/05	10.382%	
La Habra L. D. Co., Inc.	6/5	110,000.00	6/1/05	10.382%	
Lewis Clark Ec. Dev. Corp.	6/5	116,000.00	6/1/05	10.382%	
Nine County Dev., Inc.	6/5	134,000.00	6/1/05	10.382%	
Alabama Community Dev. Corp.	6/5	137,000.00	6/1/05	10.382%	
San Diego County L. D. Corp.	6/5	137,000.00	6/1/05	10.382%	
S.W. Penn. Ec. Dev. District	6/5	150,000.00	6/1/05	10.382%	
East Toledo L. D. Co.	6/5	151,000.00	6/1/05	10.382%	
Hamilton County Dev. Co., Inc.	6/5	155,000.00	6/1/05	10.382%	
Gr. Salt Lake Bus. Dis.	6/5	158,000.00	6/1/05	10.382%	
Coon Rapids Dev. Co.	6/5	173,000.00	6/1/05	10.382%	
Nevada St. Dev. Corp.	6/5	204,000.00	6/1/05	10.382%	
Long Island Dev. Corp.	6/5	212,000.00	6/1/05	10.382%	
West Virginia C. D. Corp.	6/5	213,000.00	6/1/05	10.382%	
Middle Flint Area Dev. Corp.	6/5	244,000.00	6/1/05	10.382%	
Oakland County L. D. Co.	6/5	276,000.00	6/1/05	10.382%	
Cascades West Fin. Srvs., Inc.	6/5	300,000.00	6/1/05	10.382%	
Kansas City Corp. for Ind. Dev.	6/5	325,000.00	6/1/05	10.382%	
Bay Colony Dev. Corp.	6/5	336,000.00	6/1/05	10.382%	
Gr. Muskegon Ind. Fund, Inc.	6/5	342,000.00	6/1/05	10.382%	
Ocean State B.D.A., Inc.	6/5	378,000.00	6/1/05	10.382%	
Evergreen Com. Dev. Assoc.	6/5	434,000.00	6/1/05	10.382%	
Nine County Dev., Inc.	6/5	494,000.00	6/1/05	10.382%	
Gr. Spokane Bus. Dev. Assoc.	6/5	500,000.00	6/1/05	10.382%	
Mahoning Valley Ec. Dev. Corp.	6/5	500,000.00	6/1/05	10.382%	
BEDCO Dev. Corp.	6/5	500,000.00	6/1/05	10.382%	
St. Louis County L. D. Co.	6/5	39,000.00	6/1/10	10.491%	
Phoenix L. D. Corp.	6/5	52,000.00	6/1/10	10.491%	
Gr. S.W. Kansas C.D. Co.	6/5	61,000.00	6/1/10	10.491%	
Gr. S.W. Kansas C.D. Co.	6/5	63,000.00	6/1/10	10.491%	
Warren Redev. & Plann. Corp.	6/5	71,000.00	6/1/10	10.491%	
Centralina Dev. Corp., Inc.	6/5	73,000.00	6/1/10	10.491%	
Antelope Valley L. D. Corp.	6/5	84,000.00	6/1/10	10.491%	
Mahoning Valley Ec. Dev. Corp.	6/5	85,000.00	6/1/10	10.491%	
Gulf Certco, Inc.	6/5	94,000.00	6/1/10	10.491%	
Nine County Dev., Inc.	6/5	96,000.00	6/1/10	10.491%	
San Diego County L. D. Corp.	6/5	128,000.00	6/1/10	10.491%	
La Habra L. D. C., Inc.	6/5	138,000.00	6/1/10	10.491%	
Cleveland Area Dev. Fin. Corp.	6/5	140,000.00	6/1/10	10.491%	
Springfield C. D. Co.	6/5	141,000.00	6/1/10	10.491%	
San Diego County L. D. Corp.	6/5	202,000.00	6/1/10	10.491%	
Wilmington Ind. Dev., Inc.	6/5	210,000.00	6/1/10	10.491%	
San Diego County L. D. Corp.	6/5	228,000.00	6/1/10	10.491%	
Pee Dee Regional Dev. Corp.	6/5	236,000.00	6/1/10	10.491%	
Southern Nevada C. D. Co.	6/5	247,000.00	6/1/10	10.491%	
South Shore Econ. Dev. Corp.	6/5	265,000.00	6/1/10	10.491%	
C. D. C. of Mississippi, Inc.	6/5	268,000.00	6/1/10	10.491%	
Mid-Cumberland Area Dev. Corp.	6/5	308,000.00	6/1/10	10.491%	
Georgia Mountains Reg. E.D.C.	6/5	312,000.00	6/1/10	10.491%	
Areawide Dev. Corp.	6/5	315,000.00	6/1/10	10.491%	
San Diego County L. D. Corp.	6/5	315,000.00	6/1/10	10.491%	
San Diego County L. D. Corp.	6/5	346,000.00	6/1/10	10.491%	
La Habra L. D. Co., Inc.	6/5	351,000.00	6/1/10	10.491%	
Bay Colony Dev. Corp.	6/5	413,000.00	6/1/10	10.491%	
Bay Colony Dev. Corp.	6/5	418,000.00	6/1/10	10.491%	
Bay Area Employment Dev. Co.	6/5	500,000.00	6/1/10	10.491%	
Santa Ana City L. D. Corp.	6/5	500,000.00	6/1/10	10.491%	
Columbus Countywide Dev. Corp.	6/5	500,000.00	6/1/10	10.491%	
Quaker State C. D. Co., Inc.	6/5	500,000.00	6/1/10	10.491%	
BEDCO Development Corp.	6/5	500,000.00	6/1/10	10.491%	

FEDERAL FINANCING BANK

JUNE 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
Small Business Investment Company Debentures					
Advent Industrial Cap. Co., LP	6/19	$ 1,000,000.00	6/1/88	8.975%	
Advent Atlantic Cap. Co., LP	6/19	2,500,000.00	6/1/90	9.565%	
Advent V Capital Co. LP	6/19	9,000,000.00	6/1/90	9.565%	
Advent Industrial Cap. Co., LP	6/19	1,500,000.00	6/1/90	9.565%	
Developers Equity Cap. Corp.	6/19	500,000.00	6/1/90	9.565%	
Rand SBIC, Inc.	6/19	400,000.00	6/1/90	9.565%	
Rand SBIC, Inc.	6/19	600,000.00	6/1/92	10.035%	
Sunwestern Capital Corp.	6/19	500,000.00	6/1/92	10.035%	
Super Market Investors, Inc.	6/19	500,000.00	6/1/92	10.035%	
Delta Capital, Inc.	6/19	2,150,000.00	6/1/95	10.095%	
Edwards Capital Co.	6/19	1,500,000.00	6/1/95	10.095%	
Enterprise Capital Corp.	6/19	2,000,000.00	6/1/95	10.095%	
North Star Ventures, Inc.	6/19	750,000.00	6/1/95	10.095%	
North Star Ventures II, Inc.	6/19	2,000,000.00	6/1/95	10.095%	
Rand SBIC, Inc.	6/19	600,000.00	6/1/95	10.095%	
Reedy River Ventures, Ltd.	6/19	1,500,000.00	6/1/95	10.095%	
S.W. Capital Investments, Inc.	6/19	380,000.00	6/1/95	10.095%	
Walnut Street Capital Co.	6/19	350,000.00	6/1/95	10.095%	
Western Venture Cap. Corp.	6/19	1,000,000.00	6/1/95	10.095%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
+Note A-85-09	6/28	571,228,417.48	9/30/85	7.345%	
DEPARTMENT OF TRANSPORTATION					
Section 511—4R Act					
MKT Railroad	6/3	800,000.00	9/14/99	9.922%	9.802% qtr.

+rollover

FEDERAL FINANCING BANK
JUNE 1985 Commitments

BORROWER	GUARANTOR	AMOUNT	COMMITMENT EXPIRES	MATURITY
Gary, IN	HUD	$ 480,000.00	9/1/86	9/1/89
Indianapolis, IN	HUD	668,500.00	2/1/86	2/1/90
Louisville, KY	HUD	2,150,000.00	2/1/86	2/1/91
Savannah, GA	HUD	700,000.00	8/1/86	8/1/92
Springfield, MA	HUD	3,000,000.00	8/1/86	8/1/92
Wilmington Trust Co. (BUCK)	DON	75,000,000.00	9/7/90	1/15/05
Wilmington Trust Co. (WILLIAMS)	DON	210,000,000.00	9/6/90	1/15/10

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	June 30, 1985	May 31, 1985	Net Change 6/1/85-6/30/85	Net Change—FY 1985 10/1/84-6/30/85
On-Budget Agency Debt				
Tennessee Valley Authority	$ 14,385.0	$ 14,154.0	$ 231.0	$ 950.0
Export-Import Bank	15,728.8	15,689.5	39.3	38.9
NCUA-Central Liquidity Facility	219.6	219.6	-0.1	-49.4
Off-Budget Agency Debt				
U.S. Postal Service	720.0	720.0	-0-	-367.0
U.S. Railway Association	73.8	73.8	-0-	22.5†
Agency Assets				
Farmers Home Administration	62,606.0	61,461.0	1,145.0	3,095.0
DHHS-Health Maintenance Org.	112.2	112.2	-0-	-3.9
DHHS-Medical Facilities	132.0	132.0	-0-	-0-
Overseas Private Investment Corp.	6.1	8.3	-2.2	-4.8
Rural Electrification Admin.-CBO	3,536.7	3,536.7	-0-	-0-
Small Business Administration	34.5	35.0	-0.6	-5.6
Government-Guaranteed Lending				
DOD-Foreign Military Sales	17,993.4	17,784.1	209.2	882.4
DEd.-Student Loan Marketing Assn.	5,000.0	5,000.0	-0-	-0-
DOE-Geothermal Loan Guarantees	12.4	12.4	-0-	6.2
DOE-Non-Nuclear Act (Great Plains)	1,466.5	1,461.0	5.5	176.5
DHUD-Community Dev. Block Grant	266.4	262.7	3.8	58.2
DHUD-New Communities	33.5	33.5	-0-	-0-
DHUD-Public Housing Notes	2,146.2	2,146.2	-0-	-32.3
General Services Administration	408.6	410.6	-2.0	-4.7
DOI-Guam Power Authority	35.6	35.6	-0-	-0.4
DOI-Virgin Islands	28.3	28.3	-0-	-0.4
NASA-Space Communications Co.	887.6	887.6	-0-	-67.0
DON-Ship Lease Financing	1,060.8	924.2	136.6	1,060.8
DON-Defense Production Act	5.1	5.1	0.2	2.0
Oregon Veteran's Housing	60.0	60.0	-0-	60.0
Rural Electrification Admin.	21,182.5	21,003.4	179.1	595.5
SBA-Small Business Investment Cos.	974.6	953.5	21.1	114.3
SBA-State/Local Development Cos.	546.0	527.5	18.5	191.4
TVA-Seven States Energy Corp.	1,611.9	1,589.6	22.3	56.4
DOT-Section 511	153.6	152.8	0.8	-6.0
DOT-WMATA	177.0	177.0	-0-	-0-
TOTALS*	$ 151,604.5	$ 149,597.2	$ 2,007.3	$ 6,768.4

*figures may not total due to rounding
†reflects adjustment for capitalized interest

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

STATEMENT OF THE HONORABLE MANUEL H. JOHNSON
ASSISTANT SECRETARY (ECONOMIC POLICY)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
JULY 18, 1985

I. INTRODUCTION

The Treasury Department welcomes this opportunity to present its views on monetary policy and recent monetary developments. In general, we agree with the broad outlines of the approach taken by Chairman Volcker in his July 17 testimony before this Committee. In particular, the decision to rebase the M1 target range on the average level of the money supply in the second quarter would appear to have been correct under the circumstances. The rebasing exercise removed the threat that the Federal Reserve might feel obliged to force M1 back within the original target range -- a clearly impractical undertaking. With the rebasing, successful adherence to the new targets appears to be a realistic possibility and given some recovery in monetary velocity should be consistent with a fairly strong second-half expansion of the economy. While the decision to rebase makes sense in this short-run context, it will be extremely important for the Federal Reserve to avoid any sustained period of overly rapid monetary expansion that would bring inflation back into the picture. The experience of the last two decades in this country and a wide range of experience abroad suggests very strongly that the appropriate time to fight inflation is long before the inflationary process has been allowed to build up momentum.

Granted that the recent modification of the monetary targets is defensible, the erratic short-run pattern of monetary growth in recent years -- of which this is only the most recent episode -- remains a source of some concern to the Administration. It would be highly desirable if such wide monetary swings could be avoided in the future. It must be conceded that the Federal Reserve has faced a difficult set of circumstances in recent

years. Institutional change has been rapid in the financial area, monetary velocity has become an increasingly erratic parameter and the international monetary dimension has been an additional complicating factor. But it is doubtful that these and other special factors are sufficient to account for the fact that since 1980 M1 has been outside the target range much more frequently than it has been within and that on a 13-week basis M1 growth has ranged from a high of a 17.7 percent annual rate to a low of -1.3 percent.

The Administration has consistently supported the Federal Reserve in its efforts to control inflation and promote growth. It will continue to do so. But there are some respects in which the recent record of monetary policy clearly stands in need of improvement. It may assist in clarifying these issues to state explicitly some general principles by which the Administration believes monetary policy should be guided.

II. GENERAL STATEMENT OF PRINCIPLES ON MONETARY POLICY

The Administration desires a steady, moderate rate of growth in money and counts on the Federal Reserve to carry out that responsibility. There have, of course, been occasional differences of opinion between the Administration and the Federal Reserve on specific issues of monetary technique; but there has been no difference of opinion as to the importance of controlling the growth of money over the longer run.

Agreement is general within the economics profession that over the long run inflation is a monetary phenomenon and inflation can persist only when it is accommodated by monetary expansion. This is one of the few theorems in economics which seems to have been firmly established. Therefore, control over monetary growth is absolutely essential as a long-run proposition if inflation is to be avoided. This has been a basic guiding principle of the Administration's view of monetary policy and it will continue to be.

The Administration has also felt that it is highly desirable for monetary policy to avoid short-run disturbances to the economy and to promote as low a level of interest rates as possible. It must be conceded, however, that there is far from unanimous agreement within the economics profession on the extent to which short-run variations in monetary growth exert predictable effects upon economic activity and real output. Because the short-run relationship between money and economic activity is looser and

less exact than the long-run relationship between money and the price level, the Administration has favored a cautious and gradualist short-term approach in the monetary area rather than rigid application of a monetary rule.

The original Administration plan in the monetary area to deal with double-digit inflation called for a gradual deceleration of monetary growth extending over the period from 1980 to 1986. Instead, there was an abrupt deceleration of monetary growth by the Federal Reserve in 1981 which triggered and intensified the 1981-82 recession. Subsequently, there have been a series of abrupt accelerations and decelerations in monetary growth as shown in Chart 1. The most recent episode was the virtual cessation of growth in M1 in the second half of 1984 followed by a burst of double-digit growth in M1 in the first half of this year which is still continuing to the present time.

This is not a desirable pattern. It tends to force the economy into a stop-go pattern instead of a phase of steady expansion. In addition to exerting undesirable effects on output and employment, a volatile pattern of monetary growth increases financial market uncertainty and may build an uncertainty premium into the entire structure of interest rates. Econometric work by the Treasury has suggested that this has been an important influence in recent years, holding interest rates at an earlier stage of the expansion some 200 to 300 basis points higher than they might have been if the pattern of monetary growth had been smoother.

A consistent short-run relationship between changes in monetary growth and subsequent changes in economic activity as measured by nominal GNP depends upon the existence of some degree of stability in monetary velocity (the turnover of money). As shown in Chart 2, the M1 velocity growth trend was positive throughout the period following World War II. (Monetary velocity displayed a generally negative trend in the late 19th and early 20th centuries.) A 3 percent annual increase in velocity is frequently taken as a rule of thumb estimate of the postwar trend. Research at Treasury suggests that the regularity of any stable trend in velocity is open to question. That point of view has gained force with the very erratic behavior of velocity in recent years. The reasons for the instability of velocity are complex and not yet fully understood.

The break in the velocity trend has also apparently disrupted shorter-run cyclical patterns in monetary velocity as shown below.

Changes in Monetary Velocity during
Postwar Expansions
(in percent)

	Average of Previous Expansions	Current Expansion
1st four quarters	5.5	0.0
2nd four quarters	3.3	4.1
3rd four quarters	4.2	-5.1

NOTE: Five previous expansions for the first eight quarters, four for the final four quarters. First half of 1985, which constitutes the ninth and tenth quarters of the current expansion, is expressed at an annual rate.

The recent instability of velocity has meant that a rigid and literal adherence to the original monetary targets would have been unwise. But it would be equally unwise to assume that monetary velocity will necessarily persist in its recent sluggish pattern. All that is known with certainty is that during a period of rapid institutional change in financial markets and continuing disinflation in commodity markets, velocity has grown much less than in the past. Rebasing of the monetary targets is an appropriate step to take under the circumstances, but the future behavior of velocity will require careful attention. A cautious approach should be followed since the growth rate of money will need to be cycled down if it becomes apparent that velocity is returning to growth rates more consistent with the postwar trend.

The Administration adheres to the view that the long-run rate of growth in M1 must be held to moderate proportions since it is the primary long-run determinant of inflation. In the short run, monetary volatility has been excessive in recent years and needs to be reduced. The best initial approximation for the monetary authorities should be as stable a rate of growth in M1 as they can achieve along the upper band of the rebased target range.

Monetary policy is an extremely important part of the Administration's overall economic strategy. Properly executed, monetary policy can help provide a non-inflationary environment and assist in the promotion of economic growth. But monetary policy is far from the only influence on the economy. There is a clear

need at the present time to get Federal spending under better control and thereby to move the budget deficit in a downward direction. It is equally necessary to proceed with tax reform and similar steps to enhance incentives for private sector activity. These actions are desirable in their own right and would also probably increase the ability of the monetary authorities to make a more effective contribution to economic policy.

III. MONETARY POLICY AND THE RECENT BEHAVIOR OF THE ECONOMY

Economic growth has slowed over the past year after a period of rapid expansion in the first 18 months of recovery. The rate of advance of the economy during the early phase of the recovery was the fastest for any comparable period since the recovery of 1949-50 merged with the economic impact of the Korean War. Monetary policy played a strongly supportive role in the expansion. M1 growth began to accelerate after mid-1982, after two separate periods of monetary flatness in 1981 and 1982, and the economy began to expand by late 1982, approximately six months after the upturn in money. M1 grew at nearly a 14 percent annual rate from July 1982 to June 1983 and at about a 7-1/2 percent annual rate from June 1983 to June 1984.

One of the striking features of this early phase of the expansion was the rapid advance of interest-sensitive sectors:

- o business spending for capital equipment rose at a 21 percent annual rate from late 1982 to mid-1984

- o residential construction rebounded at a 30 percent annual rate during the same period.

The rapid pace of the recovery and the strength of interest-sensitive sectors came as a surprise to those who overemphasized the short-run effects of budget deficits and high real interest rates. Most standard econometric models consistently underestimated real growth and overestimated inflation during this period. One reason for the relative failure of these economic forecasts to predict the strength of the recovery was probably their underestimation of the directly stimulative effects of accommodative monetary growth, particularly since it followed a period of intense monetary restraint and may have been largely unanticipated. Another factor of equal, if not greater, importance was the 1981 tax incentives which had powerful effects on after-tax rates of return and contributed to the stronger than expected performance of investment during the expansion.

After growing at about a 7 percent annual rate during the first six quarters of the current expansion, the economy has slowed to about a 2 percent annual rate of growth over the most recent four quarters. Employment gains have continued, although confined to the service sector of the economy, and the civilian rate of unemployment has remained stable near 7.3 percent in the first half of this year. While the overall performance of the economy has remained satisfactory and inflationary pressures are still remarkably subdued, it is understandable that this slower pace of growth would arouse concerns as to the future path of the economy and raise questions about the appropriate role of monetary policy.

There is some difference of opinion as to the causes of the current slowdown. On monetary grounds it might be argued that the current slowdown has largely been induced by very slow growth in M1 in the second half of 1984 when M1 was virtually flat from June to October, and that these effects have not yet been reversed by the rapid expansion of M1 at more than a 10 percent annual rate since last October. The recent monetary pattern is shown in Chart 3.

While this monetary view of the slowdown in real economic growth is the most likely explanation, some questions remain. The sharp drop in the growth of monetary velocity to a negative level in the first quarter of this year was probably to be expected since velocity does typically decline temporarily when monetary growth accelerates. But the persistence of negative growth in velocity through the second quarter and the absence of clear signs of resurgent economic activity have been somewhat unexpected. It is also disturbing in this connection that on purely monetary grounds a very weak first quarter was predicted for the first quarter of 1984 (which turned out to be the strongest quarter of the current expansion) and a return to high rates of inflation was predicted for 1984 (which turned out to be a very good year in terms of inflation performance).

The inherent difficulty of attempting to move from known or assumed rates of monetary growth over brief periods of time to resulting rates of growth in real activity can be seen rather readily from Chart 4. It is reasonable inference that the prolonged, if somewhat irregular, acceleration of monetary growth after late 1981 helped pull the economy to higher levels of real growth by mid-1983. It is equally reasonable to infer that a prolonged deceleration of money growth from peak levels near a 15 percent annual rate in late 1982 to less than 5 percent by 1984 has been at least partly responsible for the eventual slowdown of the economy. But it is questionable whether much

more could safely be inferred or whether the timing and extent of the economy's reaction to the latest burst of monetary growth could be predicted with very much confidence on purely monetary growth grounds.

It is generally recognized that the short-run relationship between monetary growth and economic performance is uncertain at best. Over the longer haul, however, the experience since World War II suggests that there is a close association between the two. Specifically, and without exception, periods of significant acceleration of monetary growth have been followed by some increase in the pace of economic activity. For example, the long steady acceleration in M1 growth in the late 1960's that accommodated Keynesian-type fiscal policies and the Vietnam war effort was associated with an upswing in economic activity which peaked at the end of 1969 -- with undesirable consequences in terms of inflation. More recently, as noted previously, growth of the money supply picked up sharply in late 1982 and brought the economy out of the 1982-83 recession. In the same manner, periods of significant slowdowns in monetary growth have been followed by deceleration of economic growth, for example, the 1973-1974 slowdown in money growth was followed by a recession as, more recently, was the slowing of money growth over 1981-1982.

There has never been a speedup of monetary growth in the period since World War II of the duration and magnitude that has taken place since last October without some resulting pickup in economic activity. It is therefore reasonable to expect that a recovery in economic growth lies ahead. However, the recent instability of monetary velocity introduces some additional uncertainties and leaves the exact timing and extent of any monetary-induced pickup in the economy somewhat open to question.

In addition to purely monetary influences, the current phase of slower growth can be viewed as stemming partially from real factors. Inventory restocking was an important element in the economy's initial phase of rapid advance. There was a swing from decumulation in real terms at a $25 billion rate at the recession trough in late 1982 to accumulation at a $27 billion rate during the first half of 1984. By the first half of this year, inventory accumulation had fallen back to about a $12.5 billion annual rate. Much the same pattern of a cutback in the rate of inventory accumulation following an early recovery rebound has emerged at roughly similar stages of earlier expansions, e.g., in 1962 and 1976. As such, this could be construed as a normal cyclical response to the speed of gains early in the expansion. With inventory-sales ratios now pulled down to relatively low levels, the stage may be set for a renewal of cyclical expansion.

Another real factor that may also have a bearing on the current slowdown is the behavior of the net export component of GNP. There has been a fairly steady deterioration in net exports from a surplus in late 1982 of about $25 billion at an annual rate in real terms to a deficit at nearly a $35 billion annual rate in real terms by the second quarter of this year. Since mid-1984 when the current slowdown began, industrial production has been relatively flat and manufacturing employment has declined. It is possible that steadily intensifying competition from imports since that time has been responsible for the current slowdown, but the case is weakened by the fact that the gap between changes in Gross Domestic Purchases and Gross National Product in real terms was actually slightly wider earlier in the expansion than it has been recently. It seems likely that the net export effects were masked by the rapid early pace of the expansion and are now simply more visible as growth in domestic demand has slowed.

A more mature stage of expansion is normally characterized by a transition to slower growth. Some of the reasons have been cited here and there may well be still other influences from the real side of the economy. However, a good portion of the recent slowdown in the economy can probably be attributed to last year's slow growth in money. Because of the looser relation recently between money and nominal GNP it is not possible to be precise as to the monetary influence.

Despite this uncertainty as to the proper weight to be given to real and monetary factors in explaining the recent slowdown in growth, the near-term economic outlook appears to be generally favorable. The second quarter rise in real GNP was marked down to a 1.7 percent annual rate from 3.1 percent in the flash estimate. Paradoxically, however, the composition of the revised set of figures was more favorable than the higher flash estimate and seems to point to the likelihood of better economic performance in the second half of the year.

- The bulk of the markdown from the flash estimate came in business inventory investment which is now calculated as dropping in real terms from $19 billion in the first quarter to $6 billion in the second (both figures in 1972 dollars and at annual rates). As shown in Chart 5, inventory-sales ratios are currently at relatively low levels, particularly among manufacturing industries. Thus, the second half could witness a step-up in production for inventory, which would give a lift to the economy.

- After a small decline in the first quarter, real final sales (GNP less inventory investment) grew at a 5.1 percent annual rate, according to the latest estimates, just a shade less than had been estimated in the flash. Greatest strength was in spending for structures, as residential construction, business investment in structures, and state and local construction all rose sharply. Real final sales of durable goods also registered a good gain, boosted by a resumption of shipments of computers following a hiatus in the first quarter.

- Indeed, all major components of real GNP turned in strong showings in the second quarter, with the exception of inventory investment and the net export balance.

Private economic forecasts generally call for a faster pace of expansion in the second half of the year and a continuation of real growth in 1986. Results of some major economic forecasts are summarized below:

Growth in Real GNP
(percent change, annual rate)

		1985			1986
		III	IV	IV to IV	IV to IV
Data Resources Inc.	(7/85)	2.7	2.0	2.1	2.5
Chase Econometrics	(6/25/85)	2.9	3.2	2.3	2.3
Wharton EFA	(6/26/85)	3.6	2.9	2.4	2.4
Townsend-Greenspan	(5/85)	4.1	4.3	3.3	2.1
Blue Chip Consensus	(7/10/85)	3.9	3.7	2.7	2.3

The Administration is currently reviewing its own economic projections which will be released with the Mid-Session Budget Review. The slower than expected first half will make some dent in the real growth performance for the year but for the reasons indicated previously stronger second-half performance seems very likely. Despite the generally favorable indications, stronger second half performance cannot simply be taken for granted. The duration of the current slowdown has been something of a surprise and economic forecasting is at best an uncertain art. This argues for prompt legislative action on the budget and tax reform coupled with reasonably accommodative monetary policy.

IV. SOME AREAS OF MONETARY UNCERTAINTY

Monetary policy will have to be conducted cautiously during the remainder of the year. There are risks on both sides. Too rapid a pace of monetary expansion on the heels of the sharp monetary growth since last October could sow the seeds of future inflation. Too restrictive a stance could deepen the current slowdown, widen the budget deficit and aggravate the international debt situation.

Currently, the economy is advancing while inflation is still under good control. But there are some aspects of the monetary situation which, while perhaps not unique, do seem to depart significantly from recent experience. There appear to be three of these major areas of uncertainty which make a cautious approach to monetary policy almost obligatory. Each may be clarified by experience during the balance of the year but for the time being considerable uncertainty remains.

A. The Puzzling Behavior of Monetary Velocity

Reference has already been made to the fact that the postwar trend in M1 velocity appears to have been interrupted in recent years. Velocity has behaved very unpredictably in the current expansion. In the first year of the expansion, velocity did not rise at all despite the fact that historically it has had a strong pro-cyclical pattern. That cyclical strength seemed to emerge -- a little behind schedule -- in the second year of the expansion when velocity rose at a 4 percent annual rate. But velocity has now declined at about a 5 percent annual rate during the first half of this year. This is simply another way of saying that the previous relationship has shifted in an unexpected fashion. There is still a link between money and nominal GNP but more M1 is needed to support a given level of economic activity.

In his July 17 statement, Chairman Volcker reviewed recent velocity experience and concluded that:

> "We simply do not have enough experience with the new institutional framework surrounding M1 (which will be further changed next year under existing law) to specify with any precision what new trend in velocity may be emerging or the precise nature of the relationship between fluctuations in interest rates and the money supply."

A major difficulty in this connection is separating the effects upon velocity which might be independently attributable to changes in interest rates from effects which may reflect much broader influences. As interest rates decline, the opportunity cost of holding larger cash balances also declines which may tend to reduce velocity as more money is held at any given level of GNP. But if the velocity decline is the driving force in the sequence, interest rates will decline because the economy is declining. While a decline in velocity might be regarded with relative equanimity in the first sequence it hardly would be in the second. The difficulty is knowing in advance whether interest rates are moving velocity, or whether velocity and the economy itself are moving interest rates.

Attention has been directed recently to the possibility that the observed decline in velocity may be due to the growing importance of interest-sensitive components contained in M1. Until 1980, M1 was a fairly pure measure of money held for transactions purposes. Subsequently, payment of interest on NOW and Super NOW accounts, which are included in M1, may have drawn into M1 a large amount of deposits which prior to 1980 would have been included in M2. The result may be that M1 has become more like M2 and for a given level of nominal GNP the measured level of velocity would be lowered. This conforms with the general pattern of below-trend levels of velocity in recent years and may be a partial explanation of some of the observed behavior of velocity.

It does not, however appear to offer an adequate explanation for the recent velocity slowdown which has been associated with slower economic activity this year. Some analysts have attributed the drop in velocity to the rapid growth of interest-bearing checkable accounts which have become more competitive with other interest bearing instruments. However, even if these checkables had grown no faster than noninterest bearing demand deposits, velocity still would have fallen during the first half of this year -- at about a 2 percent annual rate. Typically in the past velocity has increased by about 4 percent during the third year of an expansion.

With velocity behaving so unpredictably, the Federal Reserve cannot be sure what path of total spending and nominal GNP is likely to be associated with any given rate of growth in money. This certainly does not mean that the monetary (and credit) targets can safely be abandoned. Inflation is still a serious potential threat. But the success of a rigid monetarist approach depends ultimately on the predictability of velocity. This may not be too significant where the objective is limited to the long run control of inflation, but it assumes dominating importance where a particular short-run relationship is assumed to exist between money and nominal GNP.

The fact that recent experience is so difficult to interpret implies a need to continue to give attention to the growth rates of M1 and the other monetary aggregates, but also watch carefully other indicators of the economy's performance in order to determine whether the targets are consistent with maximum noninflationary real GNP growth.

B. Growing Importance of the International Dimension

The U.S. situation since 1980 has featured a massive net capital inflow without parallel in the postwar period. This has been the driving force in exchange markets. The reasons include low U.S. inflation, generally good to excellent U.S. economic performance, and the traditional role of the U.S. money and capital markets as a safe haven for foreign funds when there are economic difficulties abroad. Above all, the free-market orientation of the Reagan Administration and the higher prospective rate of return here on productive investment has acted as a powerful magnet attracting foreign capital.

Flows of the type, magnitude and duration we have experienced are not induced by fleeting interest rate differentials as if foreigners were shopping for a better money market fund. These massive flows have been induced by a generalized perception that the U.S. economy has found a new direction and offers significantly higher after-tax rates of return on productive investment. Some observers completely reverse these obvious lines of causation and argue that the U.S. budget deficit has driven up interest rates and pulled in foreign capital. Surely it must be obvious that this does not explain five years of dollar appreciation during which time budget deficit projections have risen and interest rates have fallen. Foreigners invest in the U.S. despite our budget deficits not because of them. It is true that our failure now to take effective action to reduce government spending coupled with overly rapid money growth could drive the dollar down, but obviously that is a sequence that we must avoid.

Capital inflows and the appreciating dollar are not the only influence on the U.S. balance of payments by any means. Differential rates of growth here and abroad, trade barriers, changing patterns of competitive ability, and U.S. export losses associated with the LDC debt situation have all exerted an important influence from time to time. The list could be lengthened. It is also important to recognize that there has been a changing

pattern within the capital accounts in the last 18 months or so. The more recent pattern has been a continuing net capital inflow to this country because of reduced U.S. outflows, partly because of reduced bank lending to Latin America.

The strength of the U.S. dollar is a testimonial to the essential correctness of the policies that the Reagan Administration has introduced. Greater emphasis on incentives to work, save and invest -- the supply side of the economy -- has been coupled with effective control of inflation -- to which the strong dollar has itself made its own important contribution. As a result, the U.S. economy has been strong, capital has flowed to this country and the dollar has been bid up in price. It is understandable that we do not want to see those successful policies reversed in an ill-advised effort to bring the dollar down.

There is considerable evidence which would suggest a fairly direct linkage between growth in the money supply and the dollar exchange rate. Because the dollar has appreciated steadily due to real factors, the monetary influence has not always been recognized but it surely exists. From October 1980 to July 1982, sharply slower money growth (4.8 percent annual rate) and lower inflation led to a rapid climb in the dollar (19.9 percent annual rate), as confidence in its purchasing power was restored and people worldwide began trying to rebuild their dollar holdings in the face of tight supply. Faster money growth from July 1982 to June 1984 (10.4 percent annual rate) accommodated the worldwide dollar build-up and slowed the dollar's advance (6.6 percent annual rate). A renewed slowdown in money growth from June 1984 to December 1984 (4.1 percent annual rate) led to a renewed surge in the dollar (23.5 percent annual rate). These successive episodes are shown in Chart 6.

Faster money growth since December 1984 finally caught up with the dollar in late February, and the dollar has fallen back from its peak levels. It is to be hoped that a more stable monetary policy and a steadier dollar will benefit hard-pressed sectors of the U.S. economy. Agriculture and mining have suffered from commodity price declines related to overly tight money and the strong dollar. Exporters and import-competing industries have also had difficulty coping with the rapid climb in the dollar's value.

The risk is that continued rapid monetary growth would begin seriously to undercut the dollar's value. This, in turn, could begin to add to inflationary pressures and to reverse the gains in that area that have been achieved in recent years. The best

course of action is for monetary policy to pursue a neutral, non-inflationary course and allow the dollar exchange rate to be determined on the basis of real factors such as comparative costs and anticipated real rates of return here and abroad.

C. The Process of Disinflation

It is clear that a disinflationary process is still continuing here and abroad. In the three months ending in March of this year, the crude materials component of the U.S. producer (wholesale) price index fell at nearly a 20 percent annual rate and by about a 10 percent annual rate in the latest three month period ending in June. When commodity prices slump, or even when commodity futures prices decline sharply, it can be a signal that the Federal Reserve is moving too rapidly toward disinflation, and is risking recession.

Some economists feel that the disinflationary process is proceeding too fast. They argue that the Federal Reserve concentrates too closely on regulating the growth of the money supply. In their view, the dollar has been made very scarce both at home and in international markets. This can be inferred, they argue, from the appreciation of the dollar since 1980, the fall in the price of gold from nearly $900 to about $300 and the persistent weakness in basic commodity prices here and abroad. Some would even argue that the Federal Reserve should substitute a price rule for a quantity rule, i.e., seek to stabilize some index of prices rather than to regulate the growth of the monetary aggregates.

The weight of economic opinion favors a quantity of money approach and that is where emphasis has been placed. However, those who have directed attention to the disinflationary process have performed a useful service. Prices have not responded to monetary growth as would have been expected on the basis of past experience. In the last analysis, it is doubtful whether any permanently rigid rule for monetary policy is likely to deal adequately with the complexities of the economy.

With the disinflationary process still continuing, the risks of a return to accelerating inflation seem to be low but the costs of being wrong would be enormous. Not quite fifteen years ago, wage and price controls were imposed with inflation little higher than it is now -- except in the wholesale price area. Following that ill-advised experiment, U.S. inflation surged to

double-digit levels and some nominal interest rates reached record peaks. Those past errors must never be repeated. And, rapid monetary growth continued long enough has always generated inflation.

On the other hand, there are signs here and abroad that inflationary pressures are much reduced. Actual deflation has been occurring in some key areas although not, of course, in terms of general price levels. This suggests that the monetary authorities will need to follow the disinflationary process by monitoring a wide range of price and cost indicators. They will also need to follow the position of the dollar in the foreign exchange markets as well as the growth of velocity in determining whether or not a certain target range for money growth is appropriate. When there is clear evidence of change, the targets can be rebased but not so frequently as to permit a purely discretionary policy with the monetary targets serving as stage scenery. There will be a continuing need for rules in the execution of monetary policy but they must be applied and interpreted in the light of changing circumstances.

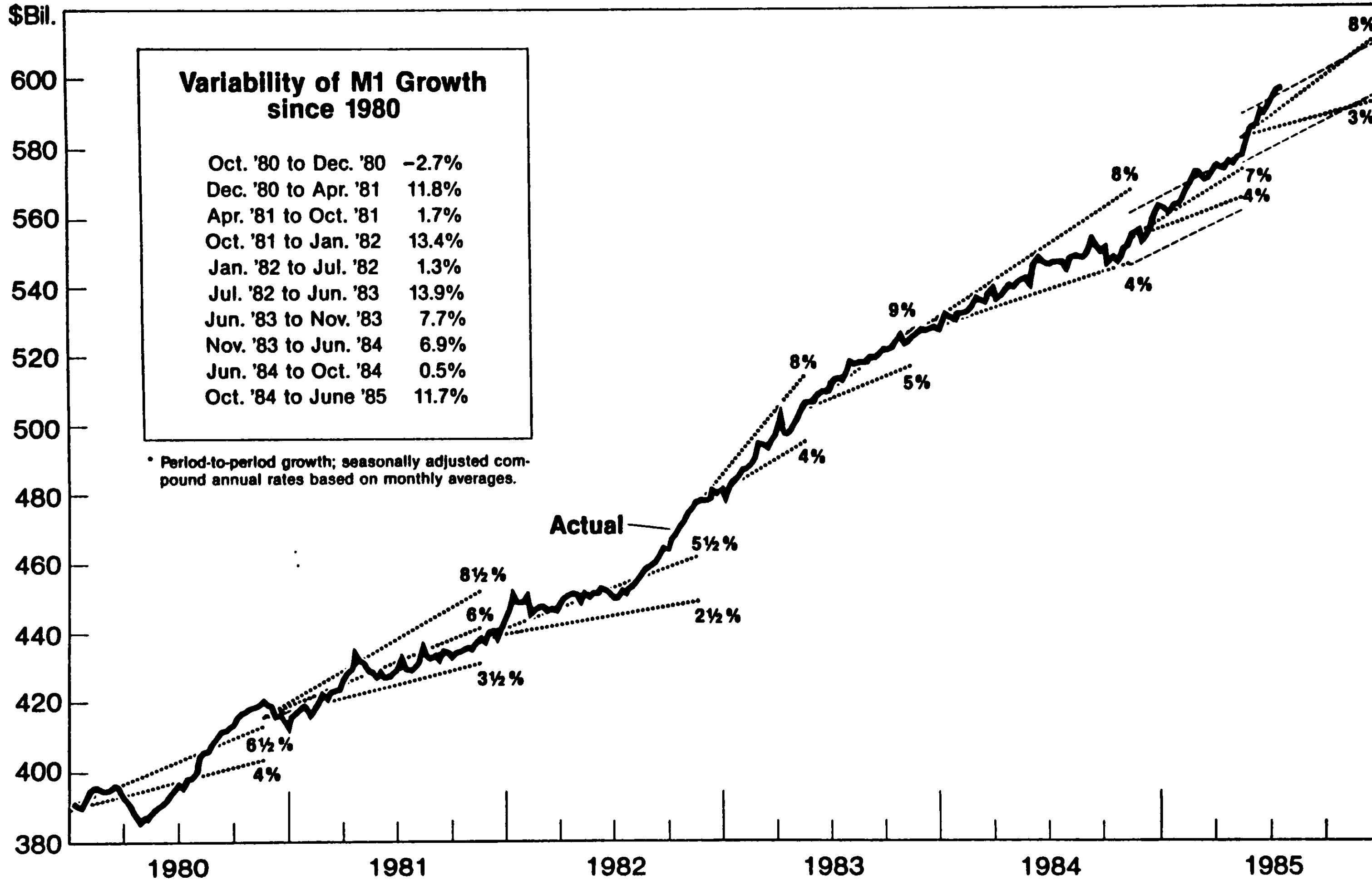
V. CONCLUSION

It would probably be a mistake to draw sweeping conclusions from recent experience with the conduct of monetary policy. The Federal Reserve appears to have been doing a reasonable job this year in dealing with a rather complex situation. The Administration has been critical of some aspects of monetary policy in the past and reserves the right of criticism in the future. But the Federal Reserve is most likely correct now in deciding to rebase its money supply target for M1 and in proceeding with caution with respect to the new target. For example, it would be possible for M1 to grow at a flat or slightly negative rate for the remainder of 1985 and still be within its new target range. This kind of swing in M1 growth would be entirely unacceptable from the Administration's point of view. However, M1 growth consistent with its upper target band seems acceptable at this point.

The economy needs the support of an accommodative monetary policy and would benefit from lower interest rates. The monetary authorities must also remain closely alert to the needs of the international situation and -- above all -- prevent any significant acceleration of inflation. They will need to follow the course of the economy very closely in the period immediately ahead.

Chart 1

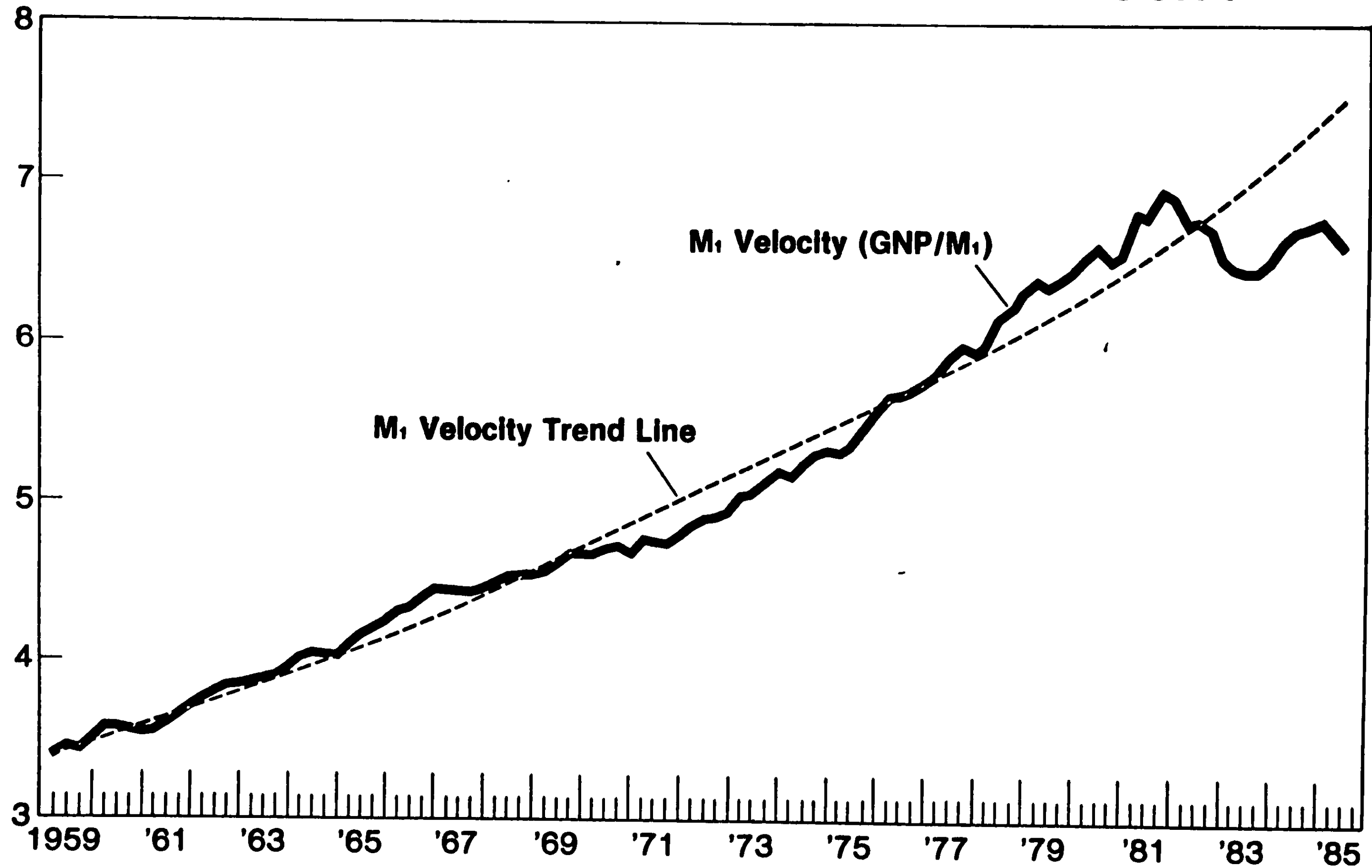
M_1 VERSUS TARGET RANGE*



*M1 data: weekly averages, seasonally adjusted.
Fed target ranges: seasonally adjusted simple annual rates based on quarterly averages.
In 1981 both M1-B and M1-B "shift adjusted" ranges are shown: the M1-B range is 6—8½%; the M1-B "shift adjusted" range is 3½—6%. Monetary bands are also shown for 1985.

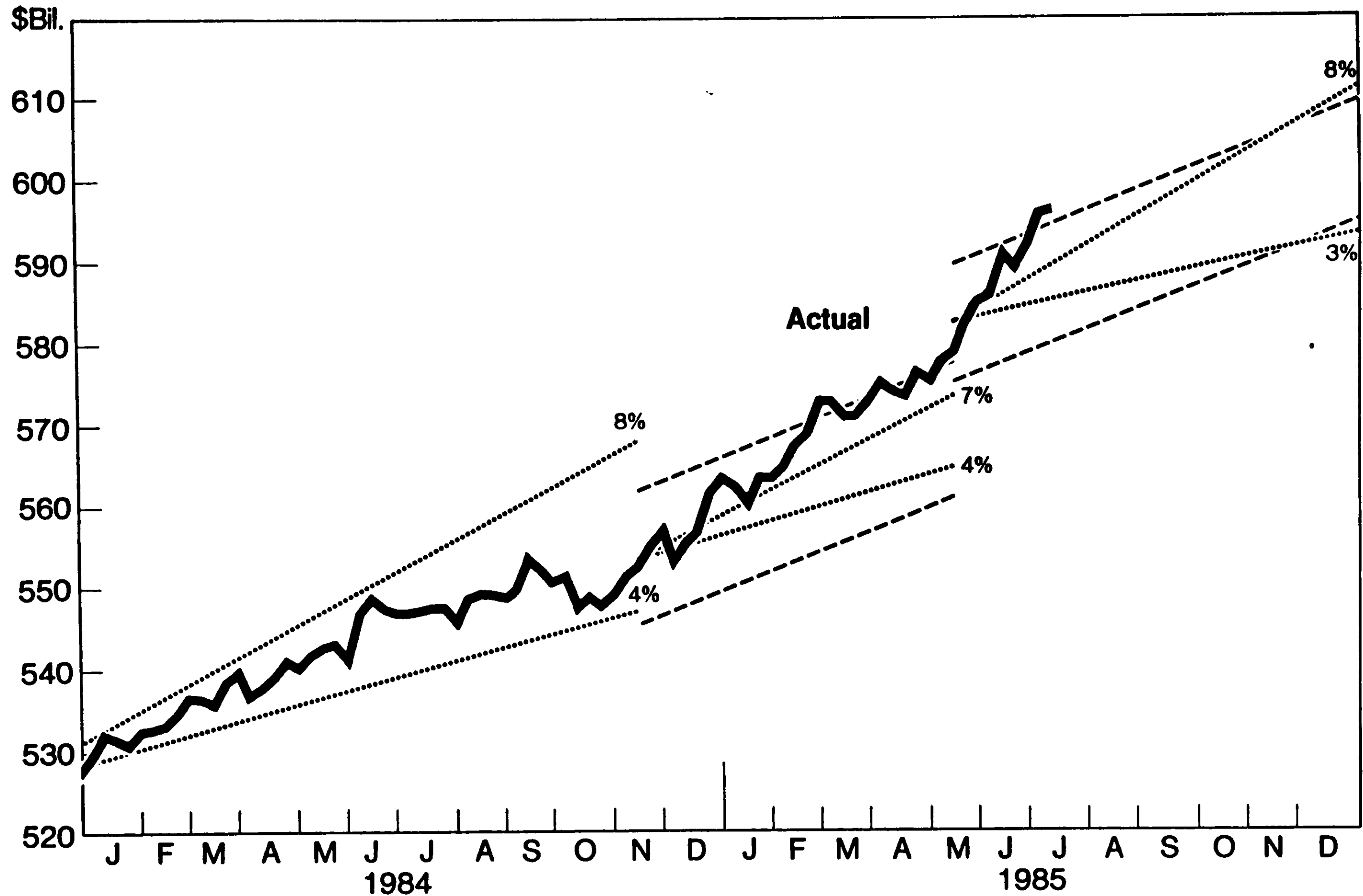
July 19, 1985-A400b

Chart 2



July 19, 1985-A418

Chart 3



* M1 data: weekly averages, seasonally adjusted.
Fed target ranges: seasonally adjusted simple annual rates based on quarterly averages.

July 19, 1985-A400

Chart 4

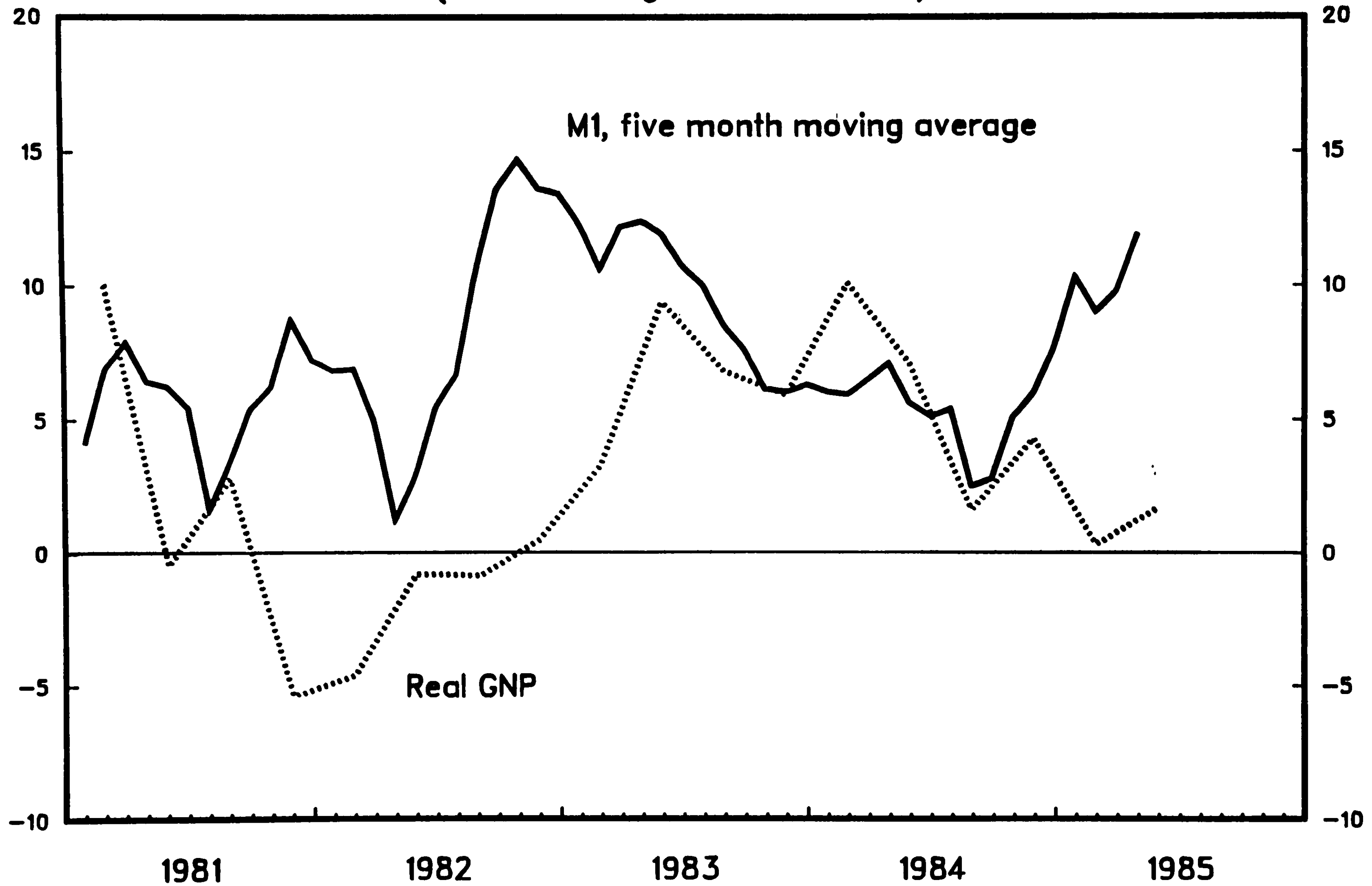
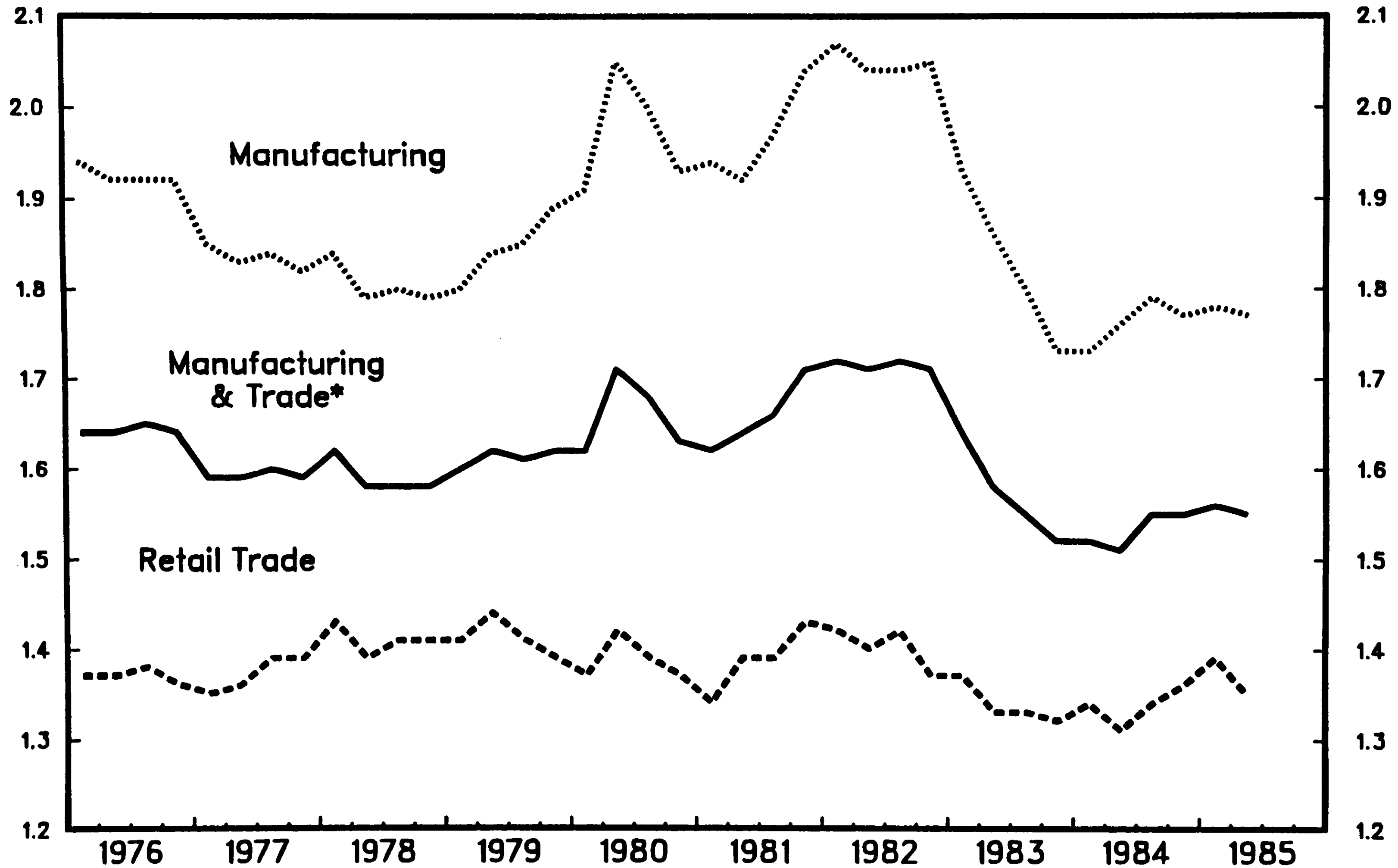


Chart 5

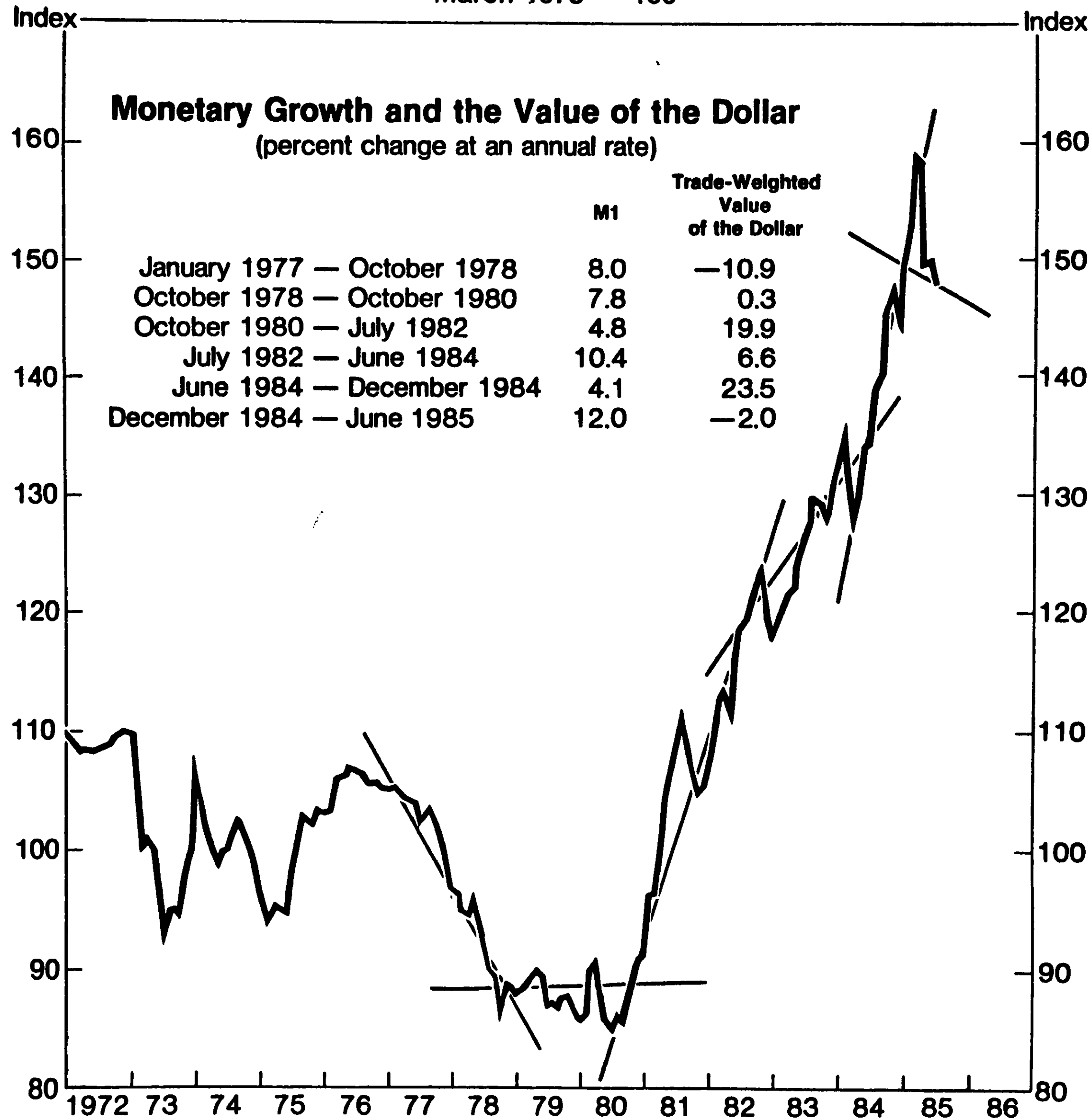
Constant-Dollar Inventory-Sales Ratios



Second quarter 1985 is estimated.
*Includes wholesale trade not shown separately.

TRADE-WEIGHTED VALUE OF THE DOLLAR

March 1973 = 100



Source: Federal Reserve Board.

July 19, 1985-A55

<u>For Immediate Release</u>   July 25, 1985

STATEMENT BY HOUSE WAYS AND MEANS COMMITTEE CHAIRMAN DAN ROSTENKOWSKI, SENATE FINANCE COMMITTEE CHAIRMAN BOB PACKWOOD, RANKING MINORITY MEMBERS JOHN DUNCAN AND RUSSELL B. LONG, AND SECRETARY OF THE TREASURY JAMES A. BAKER, III

We have received the estimates of the Joint Tax Committee staff concerning the President's tax reform proposals. Much of the estimated revenue gap is explained by differences in economic and behavioral assumptions, honest estimating errors and the use of more recent tax and economic data not available to the Treasury Department's estimators when the President's proposals were announced. All revenue estimates, of course, are subject to continuing refinement.

While the Joint Tax Committee staff's total estimated shortfall over five years amounts to less than 1 percent of the total revenue collected -- and differs from the Treasury estimate by an average of less than $3 billion per year -- we are concerned by its possible perceptual impact on the drive for tax reform.

Therefore, we want to reaffirm that revenue neutrality remains a firm underpinning of tax reform. We agree that revenue neutrality is by no means out of reach, and recognize that no mark-up will begin in the Ways and Means Committee without a proposal from the Administration that is revenue neutral.

The Administration will work with the Joint Tax Committee estimators to refine their estimates, and will move quickly to assure revenue neutrality with further proposals as necessary. Any such proposals will be made available not later than September 1, thereby permitting mark-up to begin.

We remain completely committed to passing a tax reform bill that is revenue neutral. The process is on-schedule, and we remain confident that a bill will be sent to the President.

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TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 12:00 NOON July 26, 1985

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $8,750 million of 364-day Treasury bills to be dated August 8, 1985, and to mature August 7, 1986 (CUSIP No. 912794 KP 8). This issue will provide about $275 million of new cash for the Treasury, as the maturing 52-week bill is outstanding in the amount of $8,482 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Thursday, August 1, 1985.

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.

The bills will be issued for cash and in exchange for Treasury bills maturing August 8, 1985. In addition to the maturing 52-week bills, there are $14,074 million of maturing bills which were originally issued as 13-week and 26-week bills. The disposition of this latter amount will be announced next week. Federal Reserve Banks currently hold $2,290 million as agents for foreign and international monetary authorities, and $4,419 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rate 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. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $365 million of the original 52-week issue. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-1.

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Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

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STATEMENT OF THE HONORABLE JOHN M. WALKER, JR.
ASSISTANT SECRETARY (ENFORCEMENT AND OPERATIONS)
AT THE HEARING OF THE SUBCOMMITTEE ON CRIME,
COMMITTEE ON THE JUDICIARY
U.S. HOUSE OF REPRESENTATIVES
WEDNESDAY, JULY 24, 1985

Treasury's Views on Legislation to Combat Money Laundering and Organized Crime

I want to thank the Chairman and the Committee for their continued interest in and support for our government's attack on money laundering and the illegality that it supports. I also appreciate this opportunity to testify about the several bills before the Committee that address the problem of money laundering and its connections with organized crime in our society. While all the bills before the Committee have much to commend them, I am especially pleased to discuss H.R. 2785 and 2786 (identical bills), the "Money Laundering and Related Crimes Act of 1985," which was prepared by the Department of Justice and the Department of the Treasury. Not only would this bill create a new criminal offense of money laundering, but it would significantly strengthen Treasury's Bank Secrecy Act enforcement effort. Another significant benefit of this bill is its removal of certain impediments to law enforcement posed by the Right to Financial Privacy Act. It is these aspects of the bill - the Bank Secrecy Act amendments in section 5 and the Right to Financial Privacy Act amendments in section 3 - that I will be most concerned with in my remarks today. The provisions in the bill amending the criminal code, including the new offense of money laundering, will be addressed by the Assistant Attorney General for the Criminal Division.

Before discussing the money laundering initiatives, I would like to take this opportunity to update the Committee on Treasury's Bank Secrecy Act enforcement activities since I was last before the Committee on April 16th.

First, in the wake of the criminal investigation in which the Bank of Boston pleaded guilty to numerous violations of the Bank Secrecy Act, it has become apparent that Bank Secrecy Act compliance is in need of improvement throughout the financial

community. Over forty banks have come forward to Treasury, mostly on a volunteer basis, to confess Bank Secrecy Act violations. On June 18, 1985, Treasury announced that civil penalties ranging from $210,000 to $360,000 had been imposed on four of these banks - Chase Manhattan Bank, Manufacturers Hanover Trust, Irving Trust and Chemical Bank. The appropriate disposition of the cases of many other banks that have come forward is under review.

In addition, my office has authorized the IRS to conduct criminal Bank Secrecy Act investigations of financial institutions in approximately 100 cases.

We also have been working with the financial institution regulatory agencies to strengthen their Bank Secrecy Act audit procedures. More strenuous audits should lead to discovery of more violations by financial institutions. Financial institutions whose violations are unearthed by a regulatory agency audit will be subject to more stringent civil penalties than those who have volunteered.

Second, we have strengthened the Treasury Bank Secrecy Act regulations in several respects: On May 7, 1985, regulations became effective that designated casinos as financial institutions subject to certain Bank Secrecy Act reporting and recordkeeping requirements. As evidenced by the recent hearings by the President's Commission on Organized Crime, money laundering through casinos may be even more widespread than once thought. The Treasury regulations should foreclose the attractiveness of the use of casinos for money laundering.

Finally, the "targeting" amendments to the Bank Secrecy Act regulations were published as a final rule in the Federal Register on July 8, 1985. These regulations do not themselves impose any reporting requirements. Under the regulations, however, Treasury will be able in the future to target a financial institution or a group of financial institutions for a defined period of time for reporting of specified international transactions, including wire transfers. We envision that this targeting generally will require reporting of transactions with financial institutions in designated foreign locations that would produce especially useful information on currency transaction patterns. As I will discuss later in these remarks, Treasury has clear legal authority under the Bank Secrecy Act to require reporting of international transactions without any legislative amendments.

Now, I would like to turn to H.R. 2785 and 2786. Section 5 sets forth several amendments to the Bank Secrecy Act provisions in Title 31 of the United States Code that are essential to effective enforcement of the Act by the Secretary of the Treasury.

Most importantly, the Secretary would be given for the first time summons authority both for financial institution witnesses and documents in connection with Bank Secrecy Act violations. This authority was among the legislative recommendations in the October, 1984 report of the President's Commission on Organized Crime on money laundering and is also contained in H.R. 1945 and H.R. 1367.

The Secretary may summon a financial institution officer, or employee, former officer, former employee or custodian of records who may have knowledge relating to a violation of a recordkeeping or reporting violation of the Act and require production of relevant documents. This authority is essential both to investigate violations and to assess the appropriate level of civil penalties once a violation is discovered. The purpose of the summons is limited to civil enforcement of the Bank Secrecy Act.

Under this bill, a summons would be issued only by the Secretary or by a supervisory level official of an organization to which the Secretary has delegated Bank Secrecy Act enforcement authority, e.g., the Internal Revenue Service, the Comptroller of the Currency or the Customs Service. An agent or bank examiner in the field could not issue a summons on his or her own authority.

Section 5(c) contains amendments to 31 U.S.C. § 5321, to strengthen the civil penalty provision of the Bank Secrecy Act. Under current law, the civil penalty for willful violations of BSA reporting requirements under the Act is $10,000 per violation, with an additional penalty for international transaction reporting violations. H.R. 2785 and 2786 provide for a new penalty of not more than the amount of the transaction up to $1,000,000, or $25,000, whichever is greater, for all reporting violations. For non-reporting violations, the maximum penalty will continue to be $10,000. These increased penalties will make clear to financial institutions that proper reporting is extremely important to law enforcement and that the financial consequences of non-compliance could be dire.

The bill provides a new penalty for negligent violations of the recordkeeping and reporting requirements. Negligent non-filing by banks deprives the Government of important law enforcement information, but there is some question regarding the degree of negligence that is required to satisfy the legal standard of reckless disregard, which is necessary to subject violators to civil penalties under current law. This provision would subject violators to a $10,000 civil penalty in cases of mere negligence.

Section 5(b) revises 31 U.S.C. § 5319 relating to disclosure by the Secretary of the Treasury of information reported under the Bank Secrecy Act. Currently, the Secretary is required to make such information available to a federal agency upon request. The amendment clarifies that the Secretary may also make this information available to a state or local agency and may make

disclosure to any federal agency if he has "reason to believe" the information would be useful to a matter within the receiving agency's jurisdiction, with or without a request. Disclosure may also be made to the intelligence community for national security purposes.

Finally, Section 5(f) amends the Bank Secrecy Act definition of "monetary instrument" to eliminate any possibility that the current definition could be viewed as a bar to the defining of the term "monetary instrument" by regulation to include, for example, cashier's checks and checks drawn to fictitious payees.

Section 3 sets forth several amendments to the Right to Financial Privacy Act of 1976 (Title XI of Public Law 95-630) ("RFPA"). Many of these amendments are designed to refine the extent to which financial institutions may cooperate in Federal law enforcement efforts without risking civil liability under the RFPA. These amendments would compromise no legitimate privacy interests. Several of the amendments are variations of recommendations made by the President's Commission on Organized Crime which appear in H.R. 1367.

In viewing these amendments, it is important to bear in mind that the Right to Financial Privacy Act does not confer any rights on the part of an aggrieved customer to recover damages from a bank for that bank's release of information to state law enforcement authorities or to private parties. The Act provides protection only in the case of disclosure to the federal government. It should not be used as a shield to prevent banks from voluntarily making timely disclosure of ongoing criminal activity to federal law enforcement authorities.

In my view the most important amendment is to subsection 1103(c) of the Right to Financial Privacy Act, 12 U.S.C. § 3403(c). Currently § 3403(c) provides that nothing in the Act shall preclude a financial institution from notifying a Government authority that the institution has information which may be relevant to a possible violation of any statute or regulation. The provision has created much confusion among financial institutions regarding how much information relating to the possible violation of law can be given to a Government authority without notice to the affected customers and the risk of civil liability.

For effective enforcement against money laundering, it is critical that financial institutions be free to divulge enough information about the nature of the possible violation and parties involved, so that the Government authority may proceed with a summons, subpoena or search warrant for additional information. Therefore, in order to alleviate concerns in the financial community, subsection 3(c) makes explicit that the information a financial institution may provide to law enforcement includes the name or names and other identifying information

concerning the individuals or account involved, as well as the nature of the suspected illegal activity. This provision would not authorize full disclosure of all information and records in the financial institution's possession.

Another proposed amendment would allow a financial institution to make full disclosure in certain narrowly defined situations. Subsection 1113 of the Right to Financial Privacy Act, 12 U.S.C. § 3413, is amended to allow a financial institution to provide the Government, without customer notice or fear of civil liability, all information and records which it has reason to believe may be relevant to certain possible crimes -- crimes by or against a financial institution or financial institution supervisory agency, Bank Secrecy Act violations or violations of the proposed money laundering offense, 18 U.S.C. § 1956, or enumerated drug-related crimes.

With respect to the other bills before the Committee, Treasury opposes two provisions in H.R. 1474. Section 3 of H.R. 1474 would provide that every Bank Secrecy Act reporting exemption be approved by the Secretary. Currently under the regulations, a bank may exempt from reporting certain cash deposits and withdrawals of accounts of retail businesses in amounts commensurate with the lawful, customary conduct of such a business. The bank has a continuing duty to monitor the qualifications for such exemptions, and it would be unwise, in our view, to shift the burden of monitoring the eligibility of bank customers for exemptions away from the bank. The bank is in the best position to know its customers and changes in their status. The provision is accordingly overly burdensome to the government and unnecessary. We are considering instead a regulation that would provide IRS with copies of all exempt list applications, the truthfulness of which would be compelled under the sanction of 18 U.S.C. § 1001.

Section 4 of H.R. 1474 would require that every person, including every financial institution, report all outgoing international wire transfers. As discussed above with respect to Treasury's new targeting regulations, Treasury already has authority under 31 U.S.C. § 5314 to require reporting of international wire transfers. However, wholesale reporting of international wire transfers would not be in keeping with the restriction in § 5314 that Treasury consider the need to "avoid burdening unreasonably a person making a transaction with a foreign financial agency." This broad reporting requirement would create a virtual blizzard of reports, burdening financial institutions out of all proportion to the utility of the information generated and would bury the Treasury Department in an avalanche of reporting forms, all but a very few of which would be unrelated to money laundering.

This concludes my prepared remarks. I would be happy to answer any questions from the Committee.

TREASURY NEWS

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FOR IMMEDIATE RELEASE July 29, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,204 million of 13-week bills and for $7,201 million of 26-week bills, both to be issued on August 1, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing October 31, 1985			:	26-week bills maturing January 30, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.22%	7.46%	98.175	:	7.38%	7.77%	96.269
High	7.24%	7.48%	98.170	:	7.41%	7.80%	96.254
Average	7.23%	7.47%	98.172	:	7.40%	7.79%	96.259

Tenders at the high discount rate for the 13-week bills were allotted 62%.
Tenders at the high discount rate for the 26-week bills were allotted 43%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 45,175	$ 45,175	:	$ 45,440	$ 45,440
New York	16,157,055	6,142,640	:	17,112,875	5,924,525
Philadelphia	31,235	31,235	:	26,815	26,815
Cleveland	58,565	55,265	:	34,115	34,115
Richmond	79,810	50,985	:	86,615	75,780
Atlanta	80,240	48,875	:	58,750	50,750
Chicago	1,127,835	140,130	:	1,356,420	254,480
St. Louis	73,340	52,580	:	68,170	48,170
Minneapolis	36,680	27,180	:	43,705	43,705
Kansas City	58,145	58,145	:	71,520	67,670
Dallas	46,890	36,890	:	34,045	26,195
San Francisco	1,570,135	224,850	:	1,355,465	254,675
Treasury	289,810	289,810	:	349,005	349,005
TOTALS	$19,654,915	$7,203,760	:	$20,642,940	$7,201,325
Type					
Competitive	$16,878,810	$4,427,655	:	$17,746,920	$4,305,305
Noncompetitive	1,177,545	1,177,545	:	1,099,620	1,099,620
Subtotal, Public	$18,056,355	$5,605,200	:	$18,846,540	$5,404,925
Federal Reserve	1,142,860	1,142,860	:	1,100,000	1,100,000
Foreign Official Institutions	455,700	455,700	:	696,400	696,400
TOTALS	$19,654,915	$7,203,760	:	$20,642,940	$7,201,325

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

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FOR RELEASE UPON DELIVERY
Expected at 10:00 a.m.
July 30, 1985

STATEMENT OF
RONALD A. PEARLMAN
ASSISTANT SECRETARY FOR TAX POLICY
DEPARTMENT OF THE TREASURY
BEFORE THE
SENATE COMMITTEE ON FOREIGN RELATIONS

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to appear before the Committee today to express the Administration's support for five pending income tax treaties -- treaties with Barbados, China, Cyprus, Denmark and Italy. I would first like to extend my appreciation to the Committee for its willingness to hold hearings on these treaties at this time.

As this is my first appearance before this Committee, and for some members of the Committee this is the first opportunity to consider tax treaties, I would like to spend a few moments reviewing our tax treaty program and discussing the nature of tax treaties and their benefits.

General Principles

Tax treaties are bilateral agreements designed to avoid double taxation of income and prevent evasion and avoidance of taxes. They are intended to facilitate flows of capital, trade, technology and personal services between the contracting states.

International income flows are generally subject to tax in two jurisdictions -- the country of the source of the income (i.e., where the income is generated) and the country of residence of the income recipient. Tax treaties generally assign a priority right to tax each class of income (e.g., business profits, dividends, personal service income, etc.) to one country, frequently the source country. In the case of passive income, such as dividends, interest and royalties, however, the source country's right to tax is usually restricted by providing a maximum rate at which the income may be taxed. Treaties provide for relief of double taxation by the residence country, either by the granting of a credit for the foreign income tax or

by exempting the income which is taxed by the other country. The United States avoids double taxation, both in its treaties and in its internal law, by means of a foreign tax credit.

An equally important feature of tax treaties is that they provide for cooperation between the tax authorities of the two countries. The competent authorities may exchange such information, including taxpayer information, as may be necessary for the proper administration of the countries' tax laws. The competent authorities may also resolve disputes which arise under the treaty.

In addition to the principles described above, which are common to all tax treaties, there are certain principles which are specific to U.S. treaty policy. With minor exceptions, the United States preserves its right to tax its citizens and residents under statutory rules, as though the treaty had not come into force. We view a treaty as a vehicle for granting U.S. tax benefits to residents of the other country and for granting the other country's benefits to U.S. residents.

It is also a fundamental aspect of U.S. treaty policy to limit benefits to those residents of the other country who are properly entitled to the benefits. The so-called "Limitation on Benefits" provisions of all current U.S. treaties are designed to prevent residents of third countries from establishing an entity in the other country and using it as a vehicle for deriving income from the United States, thereby receiving unjustified U.S. treaty benefits. These provisions are tailored in each treaty to reflect the potential for such abuse in that particular bilateral relationship, taking into account the interaction of the tax laws of the two countries and the other provisions of the treaty.

Benefits of Tax Treaties

Tax treaties provide substantial benefits both for the taxpayers and the tax administrations of the two contracting states. Taxpayers benefit from the substantive taxing provisions of the treaty and from those provisions of the treaty which do not confer a specific tax advantage, but serve to enhance a favorable investment climate in the partner country.

For example, treaties provide for reciprocal reductions in tax at source on payments of dividends, interest and royalties. This reduces foreign taxes paid by U.S. residents and, thus, increases the likelihood that foreign taxes will be fully creditable in the United States, or, at least, that excess credits will be reduced.

Treaties also limit the source country's right to tax other types of income of a U.S. resident. For example, they provide thresholds which must be crossed before the partner may tax a

U.S. enterprise doing business or a U.S. individual performing personal services there. A treaty partner may tax a U.S. enterprise on its business profits only to the extent that the profits are attributable to a permanent establishment in that country. This provides a way for a U.S. company to get a "foot in the door" in a country to perform feasibility studies, test markets, etc., without being subject to the host country's tax system. Similarly, individuals may visit a country for business purposes for limited periods of time without being subject to tax there. Students, government employees and pensioners also benefit from treaty rules which reduce or eliminate source country taxation of their income.

In addition to these substantive taxation benefits to U.S. persons deriving income from the other country, there are many less specific, but nonetheless beneficial, provisions of tax treaties. For example, treaties provide some assurances to U.S. investors that they will not be subject to capricious tax changes in the other country. They provide for nondiscriminatory treatment, and, when the need arises, for a mechanism to resolve disputes.

Tax administrations also benefit from tax treaties. The principal benefit is through the exchange of information provisions found in all tax treaties. Under these provisions, the tax authorities of the two countries can exchange information regarding taxpayers and their activities which is necessary for the implementation of the treaty and the proper enforcement of the countries' tax laws. The Internal Revenue Service receives information from our treaty partners, generally on a routine basis, regarding receipts of passive income by U.S. persons. In addition, information can be requested from our partners relating to specific taxpayers and transactions.

The treaty benefits granted by the United States to residents of the partner enhance the attractiveness of the United States as a location for their investments.

Treaties with Developing Countries

Three of the treaties before you today are with developing countries -- the treaties with Barbados, China and Cyprus. A special set of considerations, which I would like to discuss briefly with you, applies with respect to such treaties.

Under the standard model treaties it is the country where income arises which is called upon to make the principal revenue sacrifice. In a treaty between two developed countries, where capital flows in both directions, each country may be the source of income of residents of the other. In a treaty between a developed and a developing country, this is generally not the case. Essentially all of the capital flows to the developing

country and all of the income generated by that investment flows back to the developed country. The standard model treaties, therefore, may impose an unreasonably high revenue burden on the developing country partner. In negotiating treaties with developing countries, we seek to minimize the partner's revenue sacrifice, while still providing levels of taxation which are not so high as to inhibit flows of trade and investment. This is accomplished, for example, by providing lower thresholds for permanent establishments and personal service income than we would agree to with a developed country, and by providing for somewhat higher maximum rates for withholding at source on passive income.

Developing countries frequently seek compensation for their revenue losses in a treaty by having the developed country partner provide an incentive in the treaty for its residents to invest in the developing country. The incentive generally sought is a so-called "tax sparing credit", under which the United States would not only grant a foreign tax credit for the partner's income taxes actually paid with respect to the U.S. investor's income, but would also grant a "credit" for the taxes which would have been paid but for the host country's tax holidays designed to attract capital. While the United States is not willing to include such provisions in tax treaties, we are prepared to be flexible in many other respects in negotiating a treaty which satisfies the revenue needs of developing countries while still creating an attractive climate for investment in these countries. An increasing number of developing countries have come to recognize that a tax treaty with the United States is of value even if it contains no specific investment incentive.

Individual Treaties

I would like to turn now to a brief discussion of each of the treaties before the Committee today.

The treaties take into account the views of the Senate on specific issues, as expressed in its recent consideration of other U.S. tax treaties. Thus, for example, the rules for the taxation of gains on real property conform to the provisions of the Internal Revenue Code. Each treaty deals, in a manner appropriate to the particular circumstances, with the potential for abuse of the treaty's benefits. Each treaty also authorizes the General Accounting Office and the tax writing committees of Congress to obtain access to certain tax information exchanged under the treaty which is relevant to the function of these bodies in overseeing the administration of U.S. tax laws.

I am submitting for the record detailed technical explanations, prepared by the Treasury Department, of each of the treaties.

Italy

The proposed new Treaty with Italy was signed on April 17, 1984. It represents a comprehensive revision of the existing treaty, which has been in effect since 1955. During that interval, the income tax laws of both countries have changed significantly. In addition, model income tax treaties have been developed by the United States and the Organization of Economic Cooperation and Development (OECD). The proposed Treaty is patterned on those models.

An important feature of the new Treaty is that it covers Italy's local income tax, whereas the existing Treaty does not. Thus, when the proposed Treaty limits the tax at source on royalties to not more than 10 percent, that limitation applies to the total Italian income tax, whether imposed at the national or local level.

The proposed Treaty also differs from the existing Treaty in containing provisions which limit the tax imposed by either country on interest and capital gains derived by residents of the other country. The tax at source on interest is limited to 15 percent, with exemption on certain loans issued, guaranteed or insured by the other government. Capital gains derived by a resident of one country may be taxed by the other country only if derived from the alienation of real property (or a real property interest) situated in that other country or of the assets of a permanent establishment or fixed base used to carry on business in that other country.

In the case of dividends, the proposed Treaty retains the 15 percent maximum tax at source on dividends on portfolio holdings. However, it reduces the qualification for the 5 percent maximum tax at source to companies owning more than 50 percent of the voting stock of the company paying the dividend (compared to a 95 percent ownership test in the existing Treaty), and introduces an intermediate ceiling rate of 10 percent when the company owning the dividends owns between 10 and 50 percent of the voting stock of the paying company.

The maximum rates of tax at source on dividends, interest and royalties allowed under the proposed Treaty are higher in general than those provided in the U.S. Model treaty for negotiations with other industrial countries. However, they are comparable to rates we have agreed to in other cases where, as is the case with Italy, U.S. investment in the other country is much larger than investment by residents of the other country in the United States. Moreover, as I noted earlier, the provisions concerning dividends, interests, royalties and capital gains are more favorable to U.S. investors than under the existing Treaty.

One unusual feature of the proposed Treaty is that each country agrees to exempt from tax social security benefits paid to residents of the other country. The United States will waive the 15 percent tax on social security benefits paid to individuals who are residents of Italy, including individuals who are dual nationals. This is a concession on our part. It was agreed to because of the great importance of this provision to Italy, which was especially concerned about the burden of the tax on many residents who returned to Italy after working for long periods in the United States and whose benefits are below the threshold level for taxation in Italy. The Social Security Administration does not object to this provision, on the understanding that we regard this as an exception to U.S. tax treaty policy and not as a precedent for other such negotiations, a position with which we agree. (None of the other treaties under consideration today includes such a rule.)

China

The proposed tax Treaty with China and the accompanying protocol were signed by President Reagan on April 30, 1984, the first U.S. income tax treaty to be signed by a U.S. President.

The proposed Treaty is less detailed than the U.S. Model Income Tax Treaty, but it is remarkably similar in principle to the U.S. Model. It also takes into account the model draft income tax treaty prepared under the auspices of the United Nations specifically for use in negotiations between developed and developing countries.

The proposed Treaty provides for a maximum rate of tax at source of 10 percent on dividends, interest and royalties derived by residents of the other country. The provisions concerning the taxation of business income and personal service income are generally similar to those in other recent U.S. income tax treaties. However, the Treaty contains somewhat more generous exemptions for visiting students and teachers, reflecting China's interest in such programs and the imbalance in flows of physical capital between the two countries.

The proposed Treaty also contains provisions on exchange of information, mutual agreement procedure and limitation of benefits. I would note that, although the Chinese treaty contains a less comprehensive anti-abuse provision than is contained in some other recent treaties, we feel that the provision is more than sufficient.

Despite the fact that China's corporate income tax system is relatively new and that their economy is in the early stages of modernizing with the help of foreign investment, the proposed treaty is quite similar to other U.S. treaties. This is a tribute to the interest of the Chinese in concluding a tax treaty

with the United States. It is our judgment as well as theirs that the Treaty will contribute to greater economic and cultural contacts between the two countries as well as improving the ability of U.S. firms to compete in China's market for both goods and technology.

Denmark

The proposed new Danish income tax treaty (as modified by the accompanying Protocol), will replace the Treaty in effect since 1948. The proposed Treaty has previously been approved by the Committee.

The proposed Treaty is very similar in most respects to the OECD and U.S. Models. It provides an exemption from income tax by each country of interest and royalties derived by residents of the other country. In general, the provisions of the proposed treaty concerning the taxation of business profits and personal service income are fully consistent with the objectives of the U.S. Model Treaty. In addition, the provisions concerning exchange of information, mutual agreement procedures and non-discrimination conform to the U.S. Model Treaty and are much improved from the 1948 Treaty. Further, the Treaty retains fully the U.S. right to apply its statutory rules under FIRPTA with respect to the taxation of gains on disposition of U.S. real property interests.

The proposed Treaty also contains an article limiting its benefits to residents of the two countries. As I discussed earlier, these anti-abuse provisions are structured to deal with the situation under the particular treaty. We believe that the provision in the Danish Treaty, which is more expansive than found in our treaties with most countries, is adequate to deal with abuses of the treaty without interfering with legitimate business transactions.

One notable feature of the proposed Treaty is Denmark's agreement to extend to U.S. shareholders part of the dividend tax credit available to Danish shareholders in Danish corporations. A U.S. shareholder deriving a dividend from a Danish corporation will be granted a credit equal to 5 percent of the gross dividend when the U.S. shareholder owns at least 25 percent of the share capital of the Danish corporation paying the dividends (direct investment) and equal to 15 percent of the gross dividend in other cases (portfolio investment). The net effect of these credits will be to reduce the Danish tax on dividends paid to U.S. shareholders to 0.25 percent on direct investments and 2.25 percent on portfolio investments.

In the proposed Treaty the United States agrees to give a foreign tax credit for Danish income taxes paid by U.S. taxpayers subject to the hydrocarbon tax imposed in Denmark. The credit is

subject to the limitations of U.S. law (under Code sections 904 and 907). It is also subject to a special per-country limitation imposed by the Treaty.

There has been no ruling on the creditability of Denmark's hydrocarbon tax, but it is questionable that it would be fully creditable under U.S. law and regulations. More likely, the U.S. taxpayer would claim a partial credit under the "splitting" election provided in the foreign tax credit regulations. That amount would equal the generally applicable Danish corporate income tax on a base reduced by the hydrocarbon tax. A taxpayer electing this approach would compute the credit using the overall limitation currently provided under U.S. law. Any shortfall of credits against the U.S. tax on oil extraction income from Denmark could be offset to the extent of available excess credits for foreign income taxes paid with respect to oil extraction income from other countries.

Alternatively, under the Treaty the taxpayer could elect to credit Danish income taxes paid up to the U.S. tax on Danish oil extraction income. No spillover would be allowed of excess Danish credits to income from other countries.

Granting foreign tax credits by treaty where the taxes may not be creditable under U.S. law is no longer part of U.S. treaty policy. However, having done so in the cases of the United Kingdom and Norway, fairness dictates a similar rule for taxes paid to Denmark with respect to oil extracted from the same North Sea area. Moreover, the cost in this case is at most modest, in light of the fact that at least partial credit would be available under U.S. law, and the very small level of U.S. oil activity in Denmark. Another important offsetting factor is the tax treatment by Denmark of U.S. offshore drilling contractors in the proposed treaty, which is much more favorable than the corresponding provision in the U.K. and Norway treaties.

Barbados

The proposed Income Tax Treaty with Barbados was signed on December 31, 1984. Barbados was one of the British overseas territories to which the U.K. treaty was extended in 1959. When Barbados gained independence from Great Britain in 1966, the Treaty remained in force. As the Committee is aware, all of the U.K. extension treaties, including the Treaty with Barbados, were terminated by the United States, effective January 1, 1984. Barbados was the first of the jurisdictions whose treaties were terminated to seek a new treaty with the United States. In view of the effective termination of the old treaty as of the beginning of 1984, certain provisions of the proposed treaty, those other than the withholding provisions, will be effective for taxable years beginning on or after January 1, 1984.

There were two basic reasons for the decision to terminate the extension treaties: they did not properly reflect the nature of the economic relationship between the United States and these partners, i.e., the relationship of a developed country with a developing country; and they did not protect adequately against treaty abuse. The proposed treaty with Barbados corrects both of these shortcomings. It follows the pattern of other recent U.S. treaties with developing countries, such as the 1981 treaty with Jamaica, by allowing a broader taxing right to the source country (generally the developing country partner) than would normally be the case in a treaty with another developed country. The proposed treaty contains a comprehensive limitation on benefits provision, which was developed taking into account the special tax benefits allowed under Barbadian law to entities operating in Barbados' "offshore sector".

Anti-Abuse Provisions

Barbadian law provides for a very favorable tax regime for firms engaged in certain activities in the Barbados offshore sector. These benefits are available for so-called "international business companies", which are generally investment companies, though such companies may also be engaged in trade or the provision of non-financial services. Offshore banking enterprises, insurance companies and shipping companies receive similar benefits. Great care was taken in negotiating the Treaty to assure that residents of third countries would not be able to establish an offshore entity in Barbados, under this legislation, subject to little or no Barbadian tax, for the purpose of deriving income from the United States at favored treaty rates.

The Treaty provides that benefits otherwise provided by one of the Contracting States to a resident of the other under the treaty will not be granted under certain circumstances. Benefits will be denied if less than 50 percent of the beneficial interest in the person deriving the income is owned by residents of Barbados or the United States, or by U.S. citizens; or if a substantial part of the income of the person claiming treaty benefits is used to meet liabilities to persons other than residents of a Contracting State or U.S. citizens. However, even if these rules would otherwise operate to deny benefits, benefits will be granted if the income is derived in connection with, or is incidental to, an active business conducted in a Contracting State, other than the business of making or managing investments. The effect of these rules with respect to the Barbadian offshore sector is, in general, to deny treaty benefits to Barbadian offshore companies which are investment companies, insurance companies, or which are banks (with respect to income from traditional banking businesses). Other offshore companies, as well as other Barbadian residents owned by third country residents, will still have to meet the active business test described above in order to receive treaty benefits.

Exchange of Information

The Treaty includes a very broad exchange of information provision which will assure the Internal Revenue Service access to the information which it needs to administer the U.S. tax laws. In addition, Barbados was the first Caribbean Basin jurisdiction to enter into an exchange of information agreement (CBI Agreement) under the provisions of the Caribbean Basin Recovery Act of 1983. As a result, Barbados is now considered part of the "North American area" for purposes of the deductibility by U.S. taxpayers of expenses incurred in attending business conventions in Barbados. By virtue of the CBI Agreement, Barbados also qualifies as a jurisdiction in which a Foreign Sales Corporation (FSC) may incorporate under the FSC provisions of the Tax Reform Act of 1984. The information currently available under the CBI Agreement is the same in scope as that which is provided for under the proposed Treaty.

The exchange of information provisions of the Treaty are essentially the same as those of the U.S. Model Income Tax Treaty. The Treaty, as well as the CBI agreement, assures that the Internal Revenue Service will have access to any information available to the Barbadian tax authorities, including bank information, relating both to residents of the United States or Barbados and to third country residents. Information will be available with respect to those entities in the Barbadian offshore sector which will not be entitled to treaty benefits.

Other Provisions

Like other U.S. treaties, the proposed Treaty provides maximum rates of tax at source on dividends, interest and royalties. The maximum rates on dividends are the same as those in the U.S. Model, 15 percent in general and 5 percent on dividends paid by a subsidiary to its parent. On interest and royalties, the maximum rates are 12.5 percent, somewhat above the rates in the U.S. Model, reflecting Barbados' status as a developing country. As an exception to the general rule on interest, interest received, guaranteed or insured by the Government of the United States or Barbados, or by an instrumentality of one of the Governments, is exempt at source.

The Treaty contains rules found in most U.S. tax treaties concerning the taxation of business profits, personal service income, transportation income, real property income and capital gains. The Treaty provides a credit for the avoidance of double taxation, protection against discriminatory taxation and a dispute resolution mechanism. As noted above, some of these rules in the proposed Treaty with Barbados differ from the comparable rules in the U.S. Model by allowing a somewhat broader right to the source country to tax. These modifications are consistent with what has been done in other U.S. treaties with developing countries.

Cyprus

An Income Tax Treaty with Cyprus was signed, along with an exchange of letters, on March 19, 1984. This Treaty replaces a Treaty with Cyprus which was signed on March 26, 1980. The Committee will recall that in 1981 the Administration asked that the 1980 Treaty not be considered at hearings of this Committee in September, 1981, so that certain amendments could be made. The 1980 Treaty was returned by the Senate to the President, in December 1981, for further negotiation.

The new Treaty incorporates the changes which the Administration sought and which were endorsed by the Senate in its action of returning the Treaty to the President. The amendments relate principally to providing added assurances, first, that the benefits of the Treaty will not accrue to residents of third countries who are not properly entitled to those benefits, and, second, that Cyprus will be able to provide the information necessary for proper administration of the Treaty and U.S. tax laws by the Internal Revenue Service. We are now confident that the concerns which prompted these amendments have been fully satisfied.

Anti-Abuse Provisions

The proposed Treaty contains several provisions designed to prevent third country residents from taking unwarranted advantage of the Treaty by routing income through an entity established for that purpose in one of the Contracting States. These provisions stemmed from the fact that Cyprus has favorable internal tax law provisions which apply to foreign owned entities doing business in Cyprus and to entities established in Cyprus and doing business outside of Cyprus. The Treaty provides, in paragraph 6 of Article 4 (General Rules of Taxation), that benefits granted under the Treaty to an item of income by one of the Contracting States will not be granted if, under the law of the other State, that item of income is subject to a substantially lower tax than the tax which would apply to that item if it were derived from sources in that other State. A second anti-abuse provision, found in Article 26 (Limitation on Benefits), denies benefits under the Treaty to a resident of a Contracting State if (1) 25 percent or more of that person is owned by nonresidents of that State, or (2) regardless of ownership, that person is used as a conduit to channel deductible payments to persons who are not residents of that State. This second denial of benefits rule will not apply if the establishment, acquisition and maintenance of that person, and the conduct of its business, did not have the obtaining of treaty benefits as a principal purpose. Similarly, payments of income to a trustee in a Contracting State will not be granted treaty benefits if the income is derived in connection with a scheme a principal purpose of which is to obtain treaty benefits.

Exchange of Information

The exchange of notes accompanying the proposed Convention clarifies the fact that the Treaty will provide to the Government of Cyprus the authority necessary to implement fully the comprehensive exchange of information provisions of the Treaty, including access to bank information, information regarding corporate stock ownership and information regarding the beneficial ownership of trusts.

Other Provisions

The proposed Treaty provides for maximum rates of tax at source on payments of dividends, interest and royalties. With respect to dividends, the Treaty provides that the United States tax on dividends to a Cypriot resident may not exceed 15 percent in the case of portfolio dividends and 5 percent in the case of direct investment dividends. The rule for Cyprus source dividends is somewhat different in order to reflect the Cypriot integrated individual/corporate tax system. The Treaty provides that Cyprus may not impose any tax on dividends beyond the tax on the profits of the corporation out of which the dividends are paid. Moreover, U.S. individual dividend recipients may file for a refund of any Cyprus tax paid at the corporate level with respect to dividends received which is in excess of that individual's liability for Cypriot individual income tax.

The Treaty provides, on a reciprocal basis, for a maximum rate of tax on interest at source of 10 percent. Certain types of interest, however, are exempt at source. These include interest received, guaranteed or insured by the Government of a Contracting State or an instrumentality of that Government, interest received by a bank and interest received in connection with the sale of property or the performance of personal services. Royalties are reciprocally exempt at source.

The Treaty contains rules found in most U.S. tax treaties regarding the taxation of business profits, personal service income, transportation income, real property income and capital gains. Also included are the normal rules necessary for administering the Treaty, including rules for the resolution of disputes under the Treaty and, as noted above, the exchange of information.

We believe that the treaties with Cyprus and Barbados are good examples of the sort of constructive treaty relationship which the United States can have with a country with an "off-shore" sector. Though both Cyprus and Barbados have such "off-shore" sectors, they also have an interest in promoting real investment by nonresidents in their economies. It is this latter interest which is the focus of both treaties. Persons taking advantage of the tax haven legislation in these countries will

generally receive no benefits under the Treaty from the United States. The United States will, however, have access to whatever information it needs with respect to activities in these countries' offshore sectors.

* * *

I strongly urge prompt and favorable action by this Committee on the five treaties before you. I would be pleased to answer any questions which the Committee may have.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

FOR IMMEDIATE RELEASE
July 30, 1985

CONTACT: SUSANNE HOWARD
(202) 566-2843

SALE OF U.S. COMMEMORATIVE COINS
TO AID IN THE RESTORATION OF THE
STATUE OF LIBERTY AND ELLIS ISLAND

Washington, D.C. -- The President of the United States signed into law a bill which authorizes the U.S. Department of the Treasury to mint gold and silver coins commemorating the centennial of the Statue of Liberty and Ellis Island. U.S. Treasurer Katherine Ortega and Donna Pope, Director of the U.S. Mint attended the White House signing ceremony. The legislation provides that the proceeds from the sale of these coins will be used to aid in the restoration of the Statue and Ellis Island and establish an endowment to ensure the continued maintenance of these monuments.

In making this announcement, Mrs. Ortega said it is the goal of this Program to raise at least $40 million dollars in surcharges for the renovation of the Statue of Liberty and Ellis Island. The renovations should be completed by the centennial celebration of July 4, 1986.

The Treasury is offering a 1986 half dollar which will be emblematic of the contributions of immigrants to America, a silver dollar which depicts Ellis Island and its use as a gateway to America, and a five-dollar gold coin which will honor and feature the Statue of Liberty.

Mrs. Pope indicated that this will be the first time the Statue will be featured on U.S. coinage. All three coins will be legal tender, and will be offered in proof and uncirculated condition.

The coins will be available in various set combinations, priced from $7.50 for the single half dollar, $24.00 for the silver dollar, and $175.00 for the gold piece. Each coin will be encapsulated and presented in an attractive presentation (jewel-type) case.

Mrs. Ortega said, "These coins, will afford all Americans the opportunity to support this historic effort by purchasing something which is truly unique and has lasting value."

The bill allows for a "pre-issue discount" on all orders received prior to the issuance of such coins. It is expected that coins will begin to be available around the first of November.

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TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. July 30, 1985

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued August 8, 1985. This offering will provide about $325 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $14,074 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, August 5, 1985. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated May 9, 1985, and to mature November 7, 1985 (CUSIP No. 912794 JE 5), currently outstanding in the amount of $7,045 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,200 million, to be dated August 8, 1985, and to mature February 6, 1986 (CUSIP No. 912794 JR 6).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing August 8, 1985. In addition to the maturing 13-week and 26-week bills, there are $8,482 million of maturing 52-week bills. The disposition of this latter amount was announced last week. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $1,808 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $2,173 million as agents for foreign and international monetary authorities, and $4,419 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
July 31, 1985

CONTACT: ART SIDDON
(202) 566-2041

TREASURY RELEASES FIFTH REPORT ON U.S. CORPORATIONS IN PUERTO RICO

The Treasury Department today released its Fifth Report on The Operation and Effect of the Possessions Corporation System of Taxation. Possessions corporations are companies incorporated in one of the fifty States or the District of Columbia that are generally exempt under section 936 of the Internal Revenue Code from Federal tax on their income from Puerto Rico, Guam, and certain other U.S. possessions. These corporations are also generally exempt under industrial tax incentive programs from all or a portion of the otherwise applicable income tax imposed by Puerto Rico and the possessions.

The report released today related to tax year 1982 and the operations of section 936 under the law as in effect at that time. Thus, it does not reflect the amendments to section 936 introduced by the Tax Equity and Fiscal Responsibility Act of 1982. Those changes took effect for tax years beginning on or after January 1, 1983 and will be reported in the next annual report.

Since over 99 percent of the income of all possessions corporations is derived from Puerto Rico, the body of the report deals with the operation and effect of the possessions corporation system in Puerto Rico.

Among the principal findings of this report are:

-- The estimated tax savings to U.S. corporations of the possessions corporation provisions were $1.7 billion in 1982 (Table 4-5).

-- Possessions corporations in manufacturing industries in Puerto Rico employed approximately 81,000 persons in 1982. This represented 11 percent of total employment in Puerto Rico and 60 percent of all employees in Puerto Rico's manufacturing sector. (Tables 4-6 and 3-3.)

-- The tax savings per employee in 1982 ranged from about $3,500 in the textile and apparel industries to $69,000 in the pharmaceutical industry. The average compensation per employee in those industries was $9,000 and $21,000, respectively. For all manufacturing sectors, the average tax saving per employee was $20,656 and the average compensation $14,070. (Table 4-6).

-- The pharmaceutical industry derived one half of the total tax savings and provided 15 percent of the employment of possessions manufacturing corporations in 1982. (Table 4-7.)

-- In 1982, the net income earned by the possessions corporations engaged in manufacturing was $4.1 billion. The average ratio of operating income to operating assets for these companies was more than five times that ratio for all mainland corporations engaged in manufacturing. (Tables 4-5 and 4-3).

-- Possessions corporations also held over $10 billion of exempt financial assets in Puerto Rico at yearend 1983. Although the Puerto Rican Goverment has recently been successful in holding down the interest rate paid on those assets, the resulting effect on the level of real investment in Puerto Rico appears to have been modest. (Tables 5-1, 5-7, and 5-3).

An appendix to the Report summarizes the possessions corporation system of taxation as it applies to American Samoa and Guam and describes the tax exemption for U.S. corporations operating in the Virgin Islands in accordance with section 934(b) of the Internal Revenue Code.

Copies of the Report are available for purchase from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20401. When ordering, use Stock No. 481-787.

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THE WHITE HOUSE

Office of the Press Secretary

For Immediate Release July 30, 1985

STATEMENT BY JAMES A. BAKER III
SECRETARY OF THE TREASURY
CHAIRMAN, CABINET COUNCIL ON ECONOMIC POLICY

The President welcomes this as a step in the right direction, particularly in the area of liberalization of Japan's capital markets. But it is, of course, only a plan, and thus can only be judged on the basis of its prompt implementation and its final result toward the opening of Japan's markets to the goods of the world.

It is the view of the Cabinet Counil on Economic Policy that judgment must be reserved until the effect of the program is realized.

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TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE   July 31, 1985

TREASURY AUGUST QUARTERLY FINANCING

The Treasury will raise about $9,400 million of new cash and refund $12,341 million of securities maturing August 15, 1985, by issuing $8,500 million of 3-year notes, $6,750 million of 10-year notes, and $6,500 million of 30-year bonds. The $12,341 million of maturing securities are those held by the public, including $1,409 million held, as of today, by Federal Reserve Banks as agents for foreign and international monetary authorities.

The 10-year note and 30-year bond being offered today will be eligible for exchange in the STRIPS program and, accordingly, may be divided into their separate Interest and Principal Components and maintained on the book-entry records of the Federal Reserve Banks and Branches. Once a security is in the STRIPS form, the components may be maintained and transferred in multiples of $1,000. Financial institutions should consult their local Federal Reserve Bank or Branch for procedures for requesting securities in STRIPS form.

The three issues totaling $21,750 million are being offered to the public, and any amounts tendered by Federal Reserve Banks as agents for foreign and international monetary authorities will be added to that amount. Tenders for such accounts will be accepted at the average prices of accepted competitive tenders.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $3,275 million of the maturing securities that may be refunded by issuing additional amounts of the new securities at the average prices of accepted competitive tenders.

Details about each of the new securities are given in the attached "highlights" of the offering and in the official offering circulars. The circulars, which include the CUSIP numbers for components of securities with the STRIPS feature, can be obtained by contacting the nearest Federal Reserve Bank or Branch.

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Attachment

B-234

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC
AUGUST 1985 FINANCING TO BE ISSUED AUGUST 15, 1985

July 31, 1985

Amount Offered to the Public	$8,500 million	$6,750 million	$6,500 million
Description of Security:			
Term and type of security	3-year notes	10-year notes	30-year bonds
Series and CUSIP designation	Series T-1988 (CUSIP No. 912827 SN 3)	Series C-1995 (CUSIP No. 912827 SP 8)	Bonds of 2015 (CUSIP No. 912810 DS 4)
CUSIP Nos. for STRIPS Components	Not applicable	Listed in Attachment A of offering circular	Listed in Attachment A of offering circular
Maturity Date	August 15, 1988	August 15, 1995	August 15, 2015
Interest Rate	To be determined based on the average of accepted bids	To be determined based on the average of accepted bids	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	February 15 and August 15	February 15 and August 15
Minimum denomination available	$5,000	$1,000	$1,000
Amount Required for STRIPS	Not applicable	To be determined after auction	To be determined after auction
Terms of Sale:			
Method of sale	Yield auction	Yield auction	Yield auction
Competitive tenders	Must be expressed as an annual yield with two decimals, e.g., 7.10%	Must be expressed as an annual yield with two decimals, e.g., 7.10%	Must be expressed as an annual yield with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000	Accepted in full at the average price up to $1,000,000	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None	None	None
Payment through Treasury Tax and Loan (TT&L) Note Accounts	Acceptable for TT&L Note Option Depositaries	Acceptable for TT&L Note Option Depositaries	Acceptable for TT&L Note Option Depositaries
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
Key Dates:			
Receipt of tenders	Tuesday, August 6, 1985, prior to 1:00 p.m., EDST	Wednesday, August 7, 1985, prior to 1:00 p.m., EDST	Thursday, August 8, 1985, prior to 1:00 p.m., EDST
Settlement:			
a) cash or Federal funds	Thursday, August 15, 1985	Thursday, August 15, 1985	Thursday, August 15, 1985
b) readily-collectible check	Tuesday, August 13, 1985	Tuesday, August 13, 1985	Tuesday, August 13, 1985

TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE August 1, 1985

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $8,758 million of 52-week bills to be issued August 8, 1985, and to mature August 7, 1986, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	7.58%	8.16%	92.336
High -	7.61%	8.19%	92.305
Average -	7.60%	8.18%	92.316

Tenders at the high discount rate were allotted 78%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 72,490	$ 12,490
New York	17,115,695	8,196,995
Philadelphia	7,345	7,345
Cleveland	42,085	19,885
Richmond	52,600	31,720
Atlanta	40,980	28,780
Chicago	1,111,090	83,110
St. Louis	75,215	42,995
Minneapolis	8,865	8,865
Kansas City	42,340	41,020
Dallas	14,125	4,125
San Francisco	1,769,825	177,405
Treasury	103,195	103,195
TOTALS	$20,455,850	$8,757,930
Type		
Competitive	$18,355,800	$6,657,880
Noncompetitive	400,050	400,050
Subtotal, Public	$18,755,850	$7,057,930
Federal Reserve	1,600,000	1,600,000
Foreign Official Institutions	100,000	100,000
TOTALS	$20,455,850	$8,757,930

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE UPON DELIVERY
Expected at 2:30 p.m. MDT
4:30 p.m. EDT

Monday, August 5, 1985

Remarks by Secretary of Treasury
James A. Baker, III
before the National Governors Association
in Boise, Idaho
Monday, August 5, 1985

Introduction

I am pleased to be here with you today. I am especially pleased to see the provincial premiers from our next-door neighbor, Canada, who are here today.

Your participation in this meeting builds on the meetings in your country last March when President Reagan and Prime Minister Mulroney reaffirmed the friendship of our nations and our commitment to keep markets open. We look forward to listening, learning, and prospering together.

I am well aware of the growing interest in trade among our nation's governors. Over 30 of your states now have representation abroad to promote your exports and attract investment to your states. Such farsighted policies can pay great dividends in a world economy that is becoming more mobile and interdependent every day.

With this growing interdependence, it is essential that we devote our efforts to expanding free markets worldwide. Only the free flow of goods and services will guarantee that the abundant resources of this world are put to their most productive use.

This is not an abstract ivory-tower theory. We are talking about the living standards of all Americans. Only open markets will bring the United States the most trade benefits, give Americans the broadest selection of goods at the best prices, and provide the most jobs and income.

And for the world at large, trade and economic growth go hand in hand. In the quarter century from 1948 to 1973, world trade grew 7 percent annually. At the same time the world economy grew a remarkable 5 percent each year.

Since then, reflecting their dependence on one another, both economic and trade growth have generally been slower and more sporadic.

In the last several years, trade has been a particularly powerful stimulant to growth. A fast-growing U.S. economy has boosted the incomes of our trading partners dramatically.

Literally half the growth of European countries in 1983 and 1984 stemmed from our expansion's demand for their exports. And our imports from the less developed countries have helped to keep their severe economic problems from spinning out of control, with possible adverse consequences for our banking system.

Furthermore, imports have helped keep our level of inflation at low levels. This recovery is the first one in many years in which inflation has gone down and stayed down.

The benefits of free trade are real; we must not forget them as we examine an issue of deep concern -- the trade deficit. You are acutely aware of this issue. Your committee on International Trade and Foreign Relations speaks eloquently of its meaning to our economy and our working men and women.

Some have suggested quick-fix, meat-ax protectionist solutions that would supposedly solve the trade deficit.

But these measures would be dangerously counterproductive because they are based on a misunderstanding of the deficit.

As the saying goes, "it's not wise to try to fool Mother Nature." Nor is it wise to ignore the fundamental forces behind the trade deficit.

Faster U.S. Growth

A large part of the rising deficit has been caused by the fact that the United States has grown faster than its trading partners, something I alluded to earlier. In the first two years after our recovery began in late 1982, we grew three times as fast as Europe, and twice as fast as the rest of the industrialized world.

Such rapid growth increases our demand for imports; beleaguered foreign economies had little demand for our exports. Hence, the trade deficit has grown, just as our economy grew.

LDC Debt

Our trade deficit has also been increased by imports from less developed countries. In turn, their economies, beset by problems, have not had as much demand for our

exports. Our exports have also lagged because of the necessary adjustment policies those countries have adopted to deal with their foreign debt problems.

Strength of the Dollar

Another issue linked to the trade deficit is the strength of the dollar. Its sharp rise since the early 1980's accounted for between a third to a half of the increase in the trade balance. It has, in effect, imposed quite a "price increase" on our exporters, and a significant "price cut" on the imports that our producers must compete with. For many, a fluctuating currency can be a frightening, random phenomenon that is apparently beyond one's control.

But like the trade deficit, the strong dollar is largely a result of the vigorous U.S. economy over the last several years. The dollar has strengthened as U.S. economic performance has strengthened -- relative to previous years, and relative to other countries. Foreign investors see the United States as a flexible, resilient economy that has taken firm steps to reduce taxes, regulation and inflation.

They also see it as a political "safe-haven" for capital in an insecure world. All this drives up the desirability, and the price, of the dollar. Once again, you have a seeming paradox -- as our economy went up, so did the dollar, hurting our exporters and those who compete against imports.

Our Trade Policy: Oppose Market Distortions

The forces behind the U.S. trade deficit and the level of the dollar are basic market forces. Our trade policy must take these forces into account and allow them to bring the highest possible level of prosperity to Americans.

Policies that distort markets -- whether for products, services, investment or currencies -- should be avoided. Distortions are a disservice to all the world's economies. They create inefficiencies, and inefficiencies inevitably mean economic well-being is lower than it could, and should, be.

For these reasons there is little the government can do to directly influence, i.e. distort, the value of the dollar in exchange markets. Experience shows that efforts to move exchange rates contrary to market forces are generally ineffective and always costly, while contributing simultaneously to market uncertainty and instability.

Protectionism suffers from the same fatal flaw: it attempts to violate the law of market forces. Its fond illusions are like fancy script written on sand.

One year the illusion was that domestic content legislation would save automobile jobs.

This year the illusion written on the sand is a proposed 25 percent import surcharge.

The curious thing about this illusion is that its supporters believe the surcharge is not protectionist. You've heard of "nonbank banks." Now we have "nonprotectionist protectionism."

Here you have the assumption that no other country will react to the surcharge with protectionist threats of its own. Instead it is naively supposed that our trading partners will placidly submit to everything we ask, as if we were the only market in the world open to them.

Whatever they are, the fond illusions of protectionism are inevitably washed away by the tide of truth. Protectionist threats all too often turn into harsh reality.

Our Smoot-Hawley tariff, which Congress passed with the fondest of illusions in 1930, touched off a worldwide trade war which lasted far too many years.

Double-digit protectionism -- the 25 percent surcharge -- could cause a return of double-digit inflation. Our consumers would be harmed and manufacturers using imports might well have to lay off workers and suffer severe inefficiency.

And, here's another reality not often given its due: if protectionism reduces imports, the dollar could rise, not fall. Fewer imports would reduce the supply of dollars in the hands of foreigners and cause the increasingly scarce dollar to rise in value.

Promote Free Markets And Trade

Protectionism and exchange intervention, therefore, are not viable solutions to our trade deficit problem. Rather, we need to continue to pursue a fair, free-market, growth-oriented policy. We are cooperating with other nations in an effort to achieve solid economic growth.

And, as United States growth is slowing to a more moderate pace this year, other economies are converging with ours. As other countries' economies become more attractive for foreign investors, downward pressure on the dollar will build.

At the Bonn Summit earlier this year, the industrialized nations laid out their goals. The United States committed

itself to reducing its budget deficit. The Europeans promised to take action to strengthen employment and noninflationary growth.

Japan pledged to open its markets to imports and to continue the process of liberalizing its capital markets and internationalizing the yen. Indeed, Prime Minister Nakasone's statement to this effect last week is a step in that direction.

The Summit partners agreed that developing nations need to persevere in adjustment efforts, and that all countries must resist protectionism. In addition, we must also take care to reasonably and responsibly enforce our laws to combat unfair trade practices.

Our Policy Regarding the Dollar

At the same time, we want to improve the functioning of the international monetary system.

The Group of 10 industrial countries met in Tokyo in June for this purpose. We agreed that while the basic structure of the present system remains valid, there is a clear need to improve its functioning. Exchange market intervention can play a role, (but only a limited one) in support of other, more basic policy changes.

We are convinced that true monetary stability can be attained only if countries cooperate to achieve sound policies at home and compatible performances internationally.

This is an ambitious agenda, with a long time horizon. But we firmly believe it is the right approach. The quick fixes proposed by some will only exacerbate the problem.

We are already beginning to see some progress. The growth differentials among countries are narrowing. Other countries are achieving lower rates of inflation. And the growth prospects of less developed countries are improving, as they carry out needed adjustment policies.

Since the dollar reached its peak last winter, there has been a considerable reversal of its previous run-up. Over a third of its rise against the European currencies and the yen since 1980 has been reversed. This decline reflects our view that an orderly decline of the dollar was not a surprising outcome as our GNP growth slowed to more sustainable levels and as economic prospects improved abroad.

So, we are satisfied, though hardly complacent, about the recent performance of the dollar. The decline has been moderate and not precipitous. Like its earlier rise, the decline in the dollar was not caused by exchange market intervention, but by market forces.

We don't have a particular target in mind -- I don't think anybody knows what the "right" exchange rate for the dollar is. I do not expect a precipitous fall in the dollar, contrary to some fears I've heard expressed. Yet as our policy of promoting the convergence of economic growth continues, I would expect to see further moderate declines in the dollar.

Trade Negotiations

Finally, the United States has called for a new round of trade negotiations. Trade negotiations are the proper forum for fighting protectionism. They are a far better approach than individual countries taking uncoordinated action by themselves.

Multinational trade negotiations permit us to counterbalance powerful groups that benefit from protection with groups that would benefit from a reduction in trade barriers and a more stable and comprehensive set of trading rules. After all if we can hold off the pressures, it is the public, all consumers, who will gain.

Such negotiations should be broad in scope, since trade barriers are rapidly becoming more sophisticated and deeply rooted. All barriers to trade in goods and services and flows of direct investment should be on the table, whether such barriers are tariffs or other forms of protection. And crucial to the success of the negotiations is that both industrial and developing nations participate equally.

Our trade policy is based on the belief that allowing the individual, the business, and the nation to buy and sell freely will guarantee the most prosperity for all Americans. Freedom is the foundation of this, the greatest economy on earth. We are committed to preserving that freedom as America prepares to enter the 21st century.

State And Local Tax Deduction

Now, I don't think I could speak to this group without at least mentioning one aspect of tax reform that I know is of concern to you -- our tax reform proposal to repeal the deduction for state and local taxes.

Repealing that deduction is essential to tax reform, so let me go over a few key points that underscore this case.

Our tax plan promotes fairness, simplicity, and economic growth by cutting back tax preferences and lowering tax rates.

Take fairness first: simply put, most of the benefits from the state and local deduction go only to a well-to-do few. Repealing a deduction that primarily helps the wealthy is at the heart of any tax reform.

And, I will add parenthetically, that the deduction works against the progressivity of state taxes and actually transforms such levies as sales taxes into regressive taxes that hit hardest at the poor.

Non-itemizers making $10,000 a year must pay the full sales tax. An itemizer making $100,000 a year in the 50 percent bracket can deduct the sales tax and, in effect, pay only half of the tax.

Indeed, a full 85 percent of the tax savings from the state and local tax deduction accrues to only a narrow 25 percent of all tax returns by AGI. This is not only unfair to the poor, it discriminates against middle-income people in lower brackets. And it leaves middle-income people with only a very small share of the benefits of this deduction.

The better way to help middle-income Americans is through lower rates, higher personal exemptions, and other direct tax relief.

And, quite frankly, the state and local tax deduction has other problems. Not only is it a boon for the wealthy but it also discriminates against people of equal incomes in different states.

Second, repeal of the state and local tax deduction is critically important to our efforts to reduce marginal tax rates. And reducing those rates is essential to making our economy stronger and more internationally competitive.

If this deduction is not repealed we will see a federal revenue loss of $33 billion in 1987, and increases to $40 billion in 1990. Without recapturing this amount, a substantial cut in marginal rates would not be possible.

It reminds me of a story perhaps familiar to some of you from the Northeast. A city man was driving in a rural area of New England, and got totally, completely lost in the middle of nowhere. He stopped to ask a farmer how to get to a particular town. The farmer replied, "well, you can't get there from here."

That goes for tax reform. Without eliminating deductions, you can't get there (cut rates, boost growth) from here.

A third reason for ending the state and local tax deduction and other deductions is to promote simplicity. Ending the deduction will reduce the number of itemizers and permit more taxpayers to participate in our return-free system.

Under our plan, over half of all taxpayers will not have to fill out a tax form -- if they don't want to. The IRS will simply bill them or, much more likely, issue the refund due them.

This will be a tremendous relief for millions of Americans. It would perhaps be the most noticeable benefit of our tax reform.

Finally, let me address your concerns about how repeal of the deduction will affect your states. While ending the deduction is crucial to our overall plan, we believe the impact of this change on individual states and localities will be extremely modest.

Perhaps the most important fact to consider is that a relatively small portion of state-and-local spending is financed by deductible taxes. In 1982, taxes claimed as an itemized deduction represented only about 20 percent of all state-and-local tax spending.

In addition, it is frequently overlooked that expanding the national tax base will also expand the tax base of the 32 states that use the federal base as a reference. That would send state tax revenues up. For example, Colorado recently estimated that our plan would add $50 million to its revenues by expanding its tax base.

And, even as to state and local revenues derived from deductible taxes, the effect of repeal should be minimal. Since the majority of people would have significant marginal rate cuts, the states would benefit from more vigorous economic activity.

Now, this is not just idle talk from one man dedicated to the principle of tax reform. Recent independent studies have confirmed the belief that repeal of the deduction would have at most a very limited effect.

The National League of Cities found that total state and local spending, now increasing 7 percent annually, is only about two percent higher because of the deduction for state and local taxes. Likewise, a study by the Congressional Research Service predicted that total state and local spending would be only 1.5 percent lower if the deduction were repealed.

And even these encouraging studies leave out two major factors of benefit to state budget makers: First, the more than $20 billion of bottom-line tax relief our plan would deliver to individual taxpayers and second the political impact of the non-itemizing majority.

So, this is not the end of Western civilization as we know it, as our critics would have you believe. They point to catastrophic consequences on welfare spending, education, or other vital areas. Their analysis is, simply put, off the mark. Their alarm, when the overall effect of our proposal is calculated, is unfounded.

Let me say in closing that we face an historic opportunity to reform the tax system, for the benefit of ourselves, and for generations to come. By reducing marginal tax rates and improving the fairness of the system we can remove the drag on the prosperity of all Americans. I believe we owe the American people nothing less.

Thank you very much.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE

August 5, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,236 million of 13-week bills and for $7,228 million of 26-week bills, both to be issued on August 8, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing November 7, 1985			:	26-week bills maturing February 6, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.29%	7.53%	98.157	:	7.51%	7.92%	96.203
High	7.30%	7.54%	98.155	:	7.53%	7.94%	96.193
Average	7.30%	7.54%	98.155	:	7.52%	7.93%	96.198

Tenders at the high discount rate for the 13-week bills were allotted 37%.
Tenders at the high discount rate for the 26-week bills were allotted 7%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 46,700	$ 44,700	:	$ 48,590	$ 48,590
New York	28,764,510	6,322,040	:	19,579,455	6,050,965
Philadelphia	35,415	35,385	:	23,420	23,420
Cleveland	110,025	57,650	:	125,995	35,995
Richmond	57,745	47,745	:	86,915	52,755
Atlanta	55,180	49,750	:	113,265	103,265
Chicago	1,187,190	107,190	:	1,141,415	190,710
St. Louis	91,960	51,960	:	96,585	56,585
Minneapolis	65,670	15,670	:	47,210	47,210
Kansas City	94,810	64,125	:	68,295	64,295
Dallas	41,630	31,630	:	35,415	25,765
San Francisco	1,584,270	86,270	:	1,537,960	146,540
Treasury	321,780	321,780	:	382,100	382,100
TOTALS	$32,456,885	$7,235,895	:	$23,286,620	$7,228,195
Type					
Competitive	$29,119,340	$3,898,350	:	$20,232,045	$4,173,620
Noncompetitive	1,219,920	1,219,920	:	1,168,975	1,168,975
Subtotal, Public	$30,339,260	$5,118,270	:	$21,401,020	$5,342,595
Federal Reserve	1,439,425	1,439,425	:	1,400,000	1,400,000
Foreign Official Institutions	678,200	678,200	:	485,600	485,600
TOTALS	$32,456,885	$7,235,895	:	$23,286,620	$7,228,195

1/ Equivalent coupon-issue yield.

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

NT SECRETARY

JUL 31 1985

Dear Mr. Chairman:

Enclosed, pursuant to your request, is a detailed analysis of materials on high income taxpayers presented in summary form in Secretary Baker's testimony before the Ways and Means Committee on May 30, 1985, as well as data we have developed on the growth of partnerships and the impact of partnership losses on high income taxpayers.

Our study is based on a computer analysis of all 1983 individual income tax returns, data published by the Internal Revenue Service as part of its Statistics of Income series, and data contained in the Registered Offering Statistics file of the Securities and Exchange Commission.

I hope this information is of assistance to the Subcommittee.

Sincerely,

Ron

Ronald A. Pearlman
Assistant Secretary
(Tax Policy)

The Honorable
J.J. Pickle
Chairman, Subcommittee on Oversight
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Enclosure

cc: The Honorable Dan Rostenkowski
The Honorable John J. Duncan

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

TAXES PAID BY HIGH-INCOME TAXPAYERS AND THE GROWTH OF PARTNERSHIPS

Whether a tax system is judged to be fair depends, in part, on whether those citizens who are most able to pay taxes are perceived to pay a fair share of their income in taxes. Earlier analyses have focused on the extent to which taxpayers with high adjusted gross income (AGI) pay little or no tax. Such analyses are useful primarily in indicating the extent to which extraordinary itemized ("below-the-line") deductions reduce tax liability of high-income taxpayers. But they do not shed much light on the extent to which taxpayers with substantial economic income are able to reduce AGI, and therefore taxable income and tax liability, with various "above-the-line" losses, including losses from tax shelters.

A computer analysis of all income tax returns for 1983 filed by high-income individuals provides further information on the tax burden borne by high-income taxpayers and on the commonly used means of lowering that burden. The analysis clearly identifies partnership losses as a primary source of offset to other income and thereby of reduction in tax liability for these high-income persons. Although the study does not measure the amount of tax reduction attributable to the specific tax incentives that provide opportunities for tax shelters, recent trends in the partnership sector suggest the growth and prevalence of tax shelter activity.

I. Definition of Income

It has long been recognized that losses allowed for tax purposes are often not real economic losses; frequently they are merely accounting losses that result from tax shelter activities. Because tax losses can offset normally taxable income, it is necessary in analyzing taxes paid by high-income groups to use a measure of income which is relatively unaffected by accounting losses that may not be real.

The measure of income chosen for this purpose is total positive income (TPI), which essentially equals the sum of (1) wages and salaries, (2) interest, (3) dividends, and (4) income from profitable businesses and investments. Unlike the more commonly used measure of adjusted gross income, TPI does not subtract various exclusions or deductions which reduce AGI, such as IRA and Keogh contributions and the

60 percent of long-term capital gains that is excluded from taxable income. TPI also excludes most business and investment losses which are taken into account in computing AGI.

Based on this definition of income, a return was classified as a high-income return if total positive income exceeded $250,000. Since TPI excludes real losses as well as tax-shelter losses, it tends to overstate economic income; on the other hand, it understates economic income to the extent that tax shelter losses offset economic gains within many activities. Nonetheless, most returns with more than $250,000 of positive income can reasonably be classified as "high income." In 1983, 260,000 tax returns (or one-quarter of one percent of all returns) reported TPI in excess of $250,000; nearly 28,000 tax returns reported TPI in excess of $1 million.

II. Taxes Paid

Many taxpayers with high positive incomes paid a substantial share of their income in taxes in 1983; nearly half (47 percent) owed at least 20 percent of their TPI in tax.

A significant minority, however, owed very low taxes, in spite of the current law minimum tax. (See Table 1.)

- o Almost 30,000, or 11 percent, of returns with TPI in excess of $250,000 paid virtually no tax; that is, taxes paid were less than 5 percent of TPI.

- o Nearly twice as many owed no more than 10 percent of positive income in taxes. Fifty-five thousand, or 21 percent of all returns with positive incomes in excess of $250,000, paid 10 percent or less of positive income in taxes. Fifty-four hundred, or 19 percent, of returns with TPI over $1 million paid no more than 10 percent of positive income in taxes.

- o Over 3,000, or 11 percent, of returns with TPI in excess of $1 million paid virtually no tax.

These high-income returns paying less than 5 or 10 percent of TPI in taxes are shouldering lower tax burdens than typical returns with substantially lower incomes.

- o Upper-middle-income returns with TPI of between $30,000 and $75,000 paid on average about 13 percent of their positive income in taxes.

- Nearly 17,000 of the high-income returns with TPI exceeding $250,000 owed less than $6,272 in tax, the amount that a typical four-person family with $45,000 of income owed. Fifteen hundred returns with TPI in excess of $1 million owed less than this $6,272.

III. How Taxes Were Reduced

High-income returns with low tax liability relied most heavily on losses reported in current business activities, including those conducted in partnership form, to reduce their tax bills. (See Table 2.)

- Returns with TPI over $250,000 and taxes of less than 5 percent of TPI reported current business losses amounting, on average, to 67 percent of TPI. (Thus, for example, a typical high-income return showing TPI of $300,000 might show losses of $200,000 and AGI of $100,000; taxable income would be even less, after allowance for itemized deductions and personal exemptions.)

The capital gains exclusion and losses carried over from previous years also offset large amounts of positive income for the low-tax returns. Itemized deductions (such as for state and local taxes, mortgage interest expenses, and charitable contributions) were much less important in reducing taxes.

- For the high-income, low-tax returns--those with taxes less than 5 percent of TPI--the combination of the capital gains exclusion and losses other than on current business activities offset 46 percent of TPI. (The combination of this exclusion and these losses, together with current business losses, offset more than 100 percent of TPI, on average, for these returns.) Excess itemized deductions offset only 18 percent of TPI.

The high-income returns with relatively high tax liability--those with taxes exceeding 20 percent of positive income--seem to have more in common with the typical upper-middle-income return than with the high-income, low-tax return.

- "Above-the-line" offsets to TPI --primarily losses and the capital gains exclusion--were relatively unimportant for the high TPI returns with high taxes and for the upper-middle-income returns with TPI between $30,000 and $75,000. Current business

Table 1

1983 Returns with Total Positive Income* of $250,000 or More

	TPI Over $250,000	TPI Over $1 Million
All Returns	260,275	27,796
Returns with Taxes Paid as Percent of TPI:		
Less than 5%	29,800	3,170
5 - 10%	25,452	2,225
10 - 20%	83,173	11,307
Over 20%	121,850	11,094
Returns with:		
Partnership Losses	166,401	19,871
Partnership Losses Exceed 50% of TPI	12,655	1,600
Partnership Losses Exceed TPI	1,916	306

Office of the Secretary of the Treasury
Office of Tax Analysis
July 31, 1985

* Total Positive Income (TPI) measures gross income reported on tax returns before losses. It primarily equals the sum of positive amounts of income on the Form 1040, with the following exceptions: For capital gains, it equals long- and short-term gains before losses and before exclusions. For Schedule E, TPI includes the income on rental and royalty properties with profits, on partnerships, on estates and trusts, and on small business corporations with gain. TPI does not subtract various exclusions or deductions which reduce AGI, such as IRA and Keogh contributions, and the 60 percent exclusion of long-term capital gains.

Source: Extract from the 1983 IRS Individual Master File of all tax returns with TPI of at least $250,000.

Table 2

Ways of Reducing Income Subject to Tax

	"Above-the-Line" Offsets to TPI			"Below-the-Line" Offsets to TPI		
	Current Business Losses*	All Other Losses & Cap. Gains Exclusions**	Total, Losses & Cap. Gains Exclusions	Excess Itemized Deductions	Credits: ITC & FTC	Tax After Credits
	(Percentage of TPI)					
High TPI turns	18.3	23.2	41.5	13.6	.8	20.2
Under TPI	67.2	45.7	112.8	17.8	1.0	1.7
Over % TPI	5.8	10.7	16.5	11.6	.5	30.6
r-Middle- me Returns***	4.4	6.1	10.5	9.9	.1	12.7

ce of the Secretary of the Treasury
fice of Tax Analysis

July 31, 1985

Current Business Losses include losses on partnerships; net losses from Schedule C, Subchapter S corporations, rental and royalty properties, and farms; and net supplemental losses.

"All Other Losses and Capital Gains Exclusions" are primarily the excluded portion of capital gains plus substantial loss carryovers.

"Upper-Middle-Income Returns" have $30,000 to $75,000 of TPI.

:es: Extract from the 1983 IRS Individual Master File of all tax returns with Total Positive Income of at least $250,000; and the Treasury Individual Income Tax Model for 1983.

losses averaged only 6 percent of TPI for the high-income, high-tax group and 4 percent of TPI for the moderate TPI returns. Capital gains exclusions and other losses offset an additional 11 percent and 6 percent of TPI for the two groups, respectively.

- For both the high-income, high-tax returns and for the upper-middle-income returns, itemized deductions--"below-the-line" offsets--were almost as important as all above-the-line offsets in reducing tax liability. Itemized deductions averaged 12 and 10 percent of TPI for the two groups, respectively.

For the high-income, low-tax returns, some of the current business losses that offset so much of positive income undoubtedly represent real economic losses. However, most of the losses came from partnerships. For some years, many partnerships have been utilized as vehicles for tax shelters (defined for purposes of this paper as activities producing net losses available to offset net income from other activities), and frequently they have registered accounting losses when they have incurred no real economic losses.

- Among the 30,000 taxpayers with TPI of $250,000 or more who paid virtually no tax (i.e. tax of less than 5 percent of TPI), partnership losses alone offset an average of 36 percent of total positive income.

- Eighty-eight hundred, or 30 percent of taxpayers with TPI greater than $250,000 and tax liability below 5 percent of TPI, reported partnership losses equal to at least half of their positive incomes.

- Approximately 1,900 high-income, low-tax returns had partnership losses which fully offset positive income.

IV. The Growth in Partnerships

The growth in tax shelter activity in recent years, particularly but not exclusively in limited partnerships, has been well advertised. Some figures help document that the growth in the partnership sector has been disproportionately concentrated in partnerships registering net tax

Table 3

Partnership Activity, 1965, 1975, and 1982

	1965	1975	1982
Partnership income reported 1/ by individuals (in billions):			
Net Gain	$ 11.1	$ 18.4	$ 27.4
Net Loss	$ 1.3	$ 7.6	$ 28.3
Number of partnerships with and 2/ without net income			
All industries	914,215	1,073,094	1,514,212
Oil and gas drilling	12,467	12,974	50,837
Real estate	192,833	320,878	562,575
Agriculture	127,782	123,173	132,394
Finance	44,537	106,595	147,676
Services	168,850	198,956	287,529
Number of partnerships with profits 2/			
All industries	684,822	661,134	791,117
Oil and gas drilling	6,934	7,214	21,686
Real estate	118,563	161,928	242,156
Agriculture	92,417	74,143	67,928
Finance	29,195	58,266	80,728
Services	137,774	138,510	180,153
Number of partnerships with losses 2/			
All industries	229,393	411,960	723,095
Oil and gas drilling	5,533	5,760	29,151
Real estate	74,270	158,950	320,419
Agriculture	35,365	49,030	64,466
Finance	15,342	48,329	66,948
Services	31,076	60,446	107,376
Total losses reported on partnership returns (in billions) 2/			
All industries	$ 1.6	$ 14.7	$ 60.9
Oil and gas drilling	.1	1.7	13.2
Real estate	.6	6.5	23.0
Agriculture	.2	1.1	3.1
Finance	.1	1.8	7.4
Services	.2	1.9	6.8
Numbers of partners 2/			
All industries	2,721,899	4,950,634	9,764,667
Oil and gas drilling	NA	213,238	1,512,328
Real estate	674,489	1,549,716	3,720,805
Agriculture	322,147	351,062	448,623
Finance	317,187	1,422,954	1,983,132
Services	448,558	668,858	1,171,642

Office of the Secretary of the Treasury
Office of Tax Analysis
July 31, 1985

1/ Source: IRS Statistics of Income, Individual Income Tax Returns, Selected Years.

2/ Source: IRS Statistics of Income, Business and Partnership Tax Returns, Selected Years.

losses, in limited partnerships which are the form of business most commonly used to provide tax shelters, and in industries that are accorded favorable tax treatment such as the real estate and oil and gas industries. (See Table 3.)

Historically, the partnership sector has been the source of substantial net income for individuals. For many years, though, losses reported for tax purposes have been growing much faster than gains, and individuals have recently reported more partnership losses than gains.

- In 1965, individuals reported almost nine times as much income from partnerships as they did losses--$11.1 billion in net profits vs. $1.3 billion in net losses. By 1975, the ratio of reported income to reported loss had declined to 2.4 to 1--$18.4 billion vs. $7.6 billion. By 1982, though net partnership income had reached $27.4 billion, net losses had risen dramatically to $28.3 billion, actually exceeding net gains.

Growth in the partnership sector in recent years, much in the form of limited partnerships, has been concentrated in industries with favorable tax code treatment and therefore with opportunity for tax shelters.

- From 1965 to 1975, the total number of partnerships in all industries increased by a modest 17 percent, from some 914 thousand to almost 1.1 million. Between 1975 and 1982, formation of partnerships accelerated, with the total number of partnerships rising by 41 percent from almost 1.1 million to some 1.5 million.

- By comparison, from 1965 to 1975 the total number of partnerships in the two major tax-shelter industries, oil and gas drilling and real estate, rose by 63 percent, from some 205,000 to almost 334,000 thousand. Partnership formation in these tax-shelter industries accelerated between 1975 and 1982, with the number of partnerships increasing by 84 percent to a little over 613,000.

- Between 1979 and 1982, 41 percent of the growth in all partnerships and 74 percent of the growth in the total number of partners occurred in limited partnerships.

The rapid growth in the number of partnerships reporting losses would lack a sound business rationale if it were not for the ability of many taxpayers to use the tax losses produced by these partnerships to shelter other income from taxation.

- Between 1965 and 1982, the number of partnerships with positive net income in all industries rose by only 16 percent, from 684,000 to 791,000.

- By comparison, the number of loss partnerships more than tripled during the same period: from 229,000 in 1965 to 723,000 in 1982.

Among partnerships with losses, the growth has been particularly rapid in two industries.

- Between 1965 and 1982, the number of partnerships reporting losses in the oil and gas and real estate industries more than quadrupled. From 80,000 in 1965, the number doubled to 165,000 in 1975, and then more than doubled again to 350,000 by 1982.

While the statistics cited above indicate that tax-shelter activity has been growing rapidly, they say nothing about the importance of tax shelters in the overall economy and their distorting effect on the allocation of resources. Data from the Securities and Exchange Commission document that "tax shelters" have become a significant factor in the market for newly issued securities. (Table 4)

- In 1982 public offerings of tax shelter limited partnerships in oil and gas and in real estate equaled some $8.1 billion--almost 13 percent of all cash security offerings, and 31 percent of all cash equity offerings.

V. Conclusion

Nearly half of the high income taxpayers in 1983 paid a substantial share of their income in taxes--47 percent paid taxes of at least 20 percent of their positive income. These high-income taxpayers made hardly any more use of special provisions of the tax code for reducing tax liability than did typical upper-middle-income returns.

Table 4

Limited Partnerships and Publicly Offered Tax Shelters

1979 and 1982

	1979	1982
umber of partnerships 1/		
All partnerships	1,299,593	1,514,212
Limited partnerships	136,112	225,006
umber of partners 1/		
All partnerships	6,594,767	9,764,667
Limited partnerships	2,352,378	4,710,080
ew public offerings 2/ (in billions)		
All cash offerings	$37.6	$63.7
Cash equity offerings	$10.4	$26.3
Tax shelter limited partnerships 3/	$ 2.3	$ 8.1

fice of the Secretary of the Treasury
Office of Tax Analysis

July 31, 1985

Statistics of Income, Business Income Tax Returns, Selected Years.

Securities and Exchange Commission, Registered Offering Statistics file.

Public offerings of limited partnership interests in oil and gas drilling and real estate ventures which, in the opinion of SEC legal staff, promise significant benefits based on tax savings to the prospective investor and therefore are classified as tax shelters by the SEC.

A significant minority of the high-income returns, however, paid virtually no tax. Nearly 30,000 (or 11 percent) of the returns with TPI above $250,000 paid no more than 5 percent of TPI in taxes. Over 3,000 (or 11 percent) of returns with at least $1 million in TPI paid virtually no tax. These high-income, low-tax returns look very different from both those of typical upper-middle-income taxpayers and those of high-income taxpayers who pay at least 20 percent of TPI in taxes.

The evidence discussed in this paper supports the presumption that tax-shelter partnerships are an important vehicle for high-income individuals to reduce their tax liabilities. For the high-income returns examined here that report less than 5 percent of positive income paid in taxes, losses on current business activities--including Schedule C, partnerships, rental and royalty properties, and farms--form the largest offset to positive income. Partnership losses are by far the largest component of current business losses.

Office of the Secretary of the Treasury
Office of Tax Policy
July 31, 1985

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. August 6, 1985

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued August 15, 1985. This offering will provide about $375 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $14,036 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, August 12, 1985. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated May 16, 1985, and to mature November 14, 1985 (CUSIP No. 912794 JF 2), currently outstanding in the amount of $7,039 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,200 million, to be dated August 15, 1985, and to mature February 13, 1986 (CUSIP No. 912794 JS 4).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing August 15, 1985. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,454 million as agents for foreign and international monetary authorities, and $2,889 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

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Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE

August 6, 1985

RESULTS OF AUCTION OF 3-YEAR NOTES

The Department of the Treasury has accepted $8,524 million of $20,483 million of tenders received from the public for the 3-year notes, Series T-1988, auctioned today. The notes will be issued August 15, 1985, and mature August 15, 1988.

The interest rate on the notes will be 9-1/2%. The range of accepted competitive bids, and the corresponding prices at the 9-1/2% interest rate are as follows:

	Yield	Price
Low	9.51% 1/	99.974
High	9.54%	99.898
Average	9.53%	99.923

Tenders at the high yield were allotted 59%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 61,910	$ 45,910
New York	17,299,195	7,037,665
Philadelphia	40,305	40,305
Cleveland	133,145	128,865
Richmond	64,880	60,240
Atlanta	119,495	92,165
Chicago	1,125,215	317,865
St. Louis	163,245	140,285
Minneapolis	84,670	79,710
Kansas City	185,390	182,185
Dallas	29,395	27,395
San Francisco	1,171,830	367,390
Treasury	4,005	4,005
Totals	$20,482,680	$8,523,985

The $8,524 million of accepted tenders includes $1,255 million of noncompetitive tenders and $7,269 million of competitive tenders from the public.

In addition to the $8,524 million of tenders accepted in the auction process, $460 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,825 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

1/ Excepting 1 tender of $165,000.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE August 7, 1985

RESULTS OF AUCTION OF 10-YEAR NOTES

The Department of the Treasury has accepted $ 6,758 million of $15,795 million of tenders received from the public for the 10-year notes, Series C-1995, auctioned today. The notes will be issued August 15, 1985, and mature August 15, 1995.

The interest rate on the notes will be 10-1/2%.1/ The range of accepted competitive bids, and the corresponding prices at the 10-1/2% interest rate are as follows:

	Yield	Price
Low	10.58%	99.514
High	10.61%	99.332
Average	10.60%	99.392

Tenders at the high yield were allotted 31%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 30,902	$ 14,522
New York	13,885,280	6,155,924
Philadelphia	8,510	8,510
Cleveland	138,309	24,509
Richmond	24,500	14,500
Atlanta	20,157	14,467
Chicago	819,748	235,148
St. Louis	138,653	128,653
Minneapolis	33,023	19,223
Kansas City	73,264	72,264
Dallas	10,295	8,295
San Francisco	610,393	60,453
Treasury	1,631	1,631
Totals	$15,794,665	$6,758,099

The $ 6,758 million of accepted tenders includes $ 686 million of noncompetitive tenders and $ 6,072 million of competitive tenders from the public.

In addition to the $ 6,758 million of tenders accepted in the auction process, $380 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $800 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

1/ The minimum par amount required for STRIPS is $400,000. Larger amounts must be in multiples of that amount.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE　　　　　　　　　　　　August 8, 1985

RESULTS OF AUCTION OF 30-YEAR TREASURY BONDS

The Department of the Treasury has accepted $6,501 million of $15,032 million of tenders received from the public for the 30-year bonds auctioned today. The bonds will be issued August 15, 1985, and mature August 15, 2015.

The interest rate on the bonds will be 10-5/8%.1/ The range of accepted competitive bids, and the corresponding prices at the 10-5/8% interest rate are as follows:

	Yield	Price
Low	10.64%	99.865
High	10.68%	99.508
Average	10.66%	99.686

Tenders at the high yield were allotted 91%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 755	$ 755
New York	13,519,599	5,996,254
Philadelphia	405	405
Cleveland	91,403	37,803
Richmond	8,459	4,459
Atlanta	23,380	5,380
Chicago	653,593	217,143
St. Louis	88,757	88,757
Minneapolis	14,074	8,624
Kansas City	19,226	19,225
Dallas	4,422	2,422
San Francisco	607,251	119,451
Treasury	223	223
Totals	$15,031,547	$6,500,901

The $6,501 million of accepted tenders includes $464 million of noncompetitive tenders and $6,037 million of competitive tenders from the public.

In addition to the $6,501 million of tenders accepted in the auction process, $650 million of tenders was accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

1/ The minimum par amount required for STRIPS is $320,000. Larger amounts must be in multiples of that amount.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE August 12, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,212 million of 13-week bills and for $7,306 million of 26-week bills, both to be issued on August 15, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing November 14, 1985			:	26-week bills maturing February 13, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.12% a/	7.35%	98.200	:	7.36%	7.75%	96.279
High	7.15%	7.38%	98.193	:	7.38%	7.77%	96.269
Average	7.14%	7.37%	98.195	:	7.36%	7.75%	96.279

a/ Excepting 1 tender of $740,000.

Tenders at the high discount rate for the 13-week bills were allotted 21%.
Tenders at the high discount rate for the 26-week bills were allotted 2%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 52,500	$ 52,500	:	$ 44,350	$ 44,350
New York	14,829,575	6,081,125	:	30,026,290	6,326,875
Philadelphia	26,960	26,960	:	29,715	29,715
Cleveland	50,700	50,700	:	50,620	40,010
Richmond	53,180	53,180	:	85,545	69,625
Atlanta	60,850	56,900	:	129,600	42,825
Chicago	1,029,380	122,980	:	1,100,820	116,055
St. Louis	90,660	49,990	:	101,755	55,795
Minneapolis	65,360	65,360	:	46,215	21,715
Kansas City	93,235	66,435	:	67,420	66,150
Dallas	35,435	35,435	:	34,930	25,030
San Francisco	1,559,695	230,405	:	1,292,590	82,110
Treasury	319,810	319,810	:	385,270	385,270
TOTALS	$18,267,340	$7,211,780	:	$33,395,120	$7,305,525
Type					
Competitive	$14,991,705	$3,936,145	:	$30,027,000	$3,937,405
Noncompetitive	1,212,365	1,212,365	:	1,164,375	1,164,375
Subtotal, Public	$16,204,070	$5,148,510	:	$31,191,375	$5,101,780
Federal Reserve	1,513,515	1,513,515	:	1,475,000	1,475,000
Foreign Official Institutions	549,755	549,755	:	728,745	728,745
TOTALS	$18,267,340	$7,211,780	:	$33,395,120	$7,305,525

An additional $ 54,545 thousand of 13-week bills and an additional $ 87,055 thousand of 26-week bills will be issued to foreign official institutions for new cash.

1/ Equivalent coupon-issue yield.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

August 13, 1985

Robert M. Kimmitt
General Counsel

On June 17, 1985 the Senate confirmed President Reagan's nomination of Robert M. Kimmitt as General Counsel of the Department of the Treasury. As General Counsel, he is responsible for all the legal work in the Department and serves as principal legal adviser to the Secretary, Deputy Secretary, and other senior departmental officials.

Before joining the Treasury Department, Mr. Kimmitt had served at the White House since 1983 as Deputy Assistant to the President for National Security Affairs and Executive Secretary and General Counsel of the National Security Council.

After being commissioned as a regular army officer in 1969 at West Point, Mr. Kimmitt completed field artillery, airborne, and ranger schools. He served a 17-month combat tour with the 173rd Airborne Brigade in Vietnam (1970-1971) and was the assigned to the 101st Airborne Division at Ft. Campbell, Kentucky (1972-1974). He attended Georgetown University Law School from 1974-1977, during which time he also served as legislative counsel to the Army's Chief of Legislative Liaison (Summer 1975) and then as a NSC staff member specializing in arms sales policy (1976-1977). Upon graduation from law school, he served as a law clerk to Judge Edward Allen Tamm of the U.S. Court of Appeals for the D.C. Circuit (1977-1978). He returned to NSC staff in 1978, serving both as Legal Counsel and Arms Sales Policy Officer until early 1982, when he left active military service to join the senior staff of the NSC. In 1982-1983 he served as General Counsel and Director of Legislative Affairs and Security Assistance for the NSC.

Mr. Kimmitt was graduated from the United States Military Academy at West Point (B.S. 1969) and Georgetown University Law Center (J.D. 1977). He is married to the former Holly Sutherland, they have four children and reside in Arlington, Virginia. He was born December 19, 1947 in Logan, Utah.

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TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. August 13, 1985

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued August 22, 1985. This offering will provide about $325 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $14,081 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, August 19, 1985. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated May 23, 1985, and to mature November 21, 1985 (CUSIP No. 912794 JG 0), currently outstanding in the amount of $7,035 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated February 21, 1985, and to mature February 20, 1986 (CUSIP No. 912794 JT 2), currently outstanding in the amount of $8,525 million, the additional and original bills to be freely interchangeable.

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.

The bills will be issued for cash and in exchange for Treasury bills maturing August 22, 1985. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,037 million as agents for foreign and international monetary authorities, and $3,302 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. August 14, 1985

TREASURY TO AUCTION $9,250 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $9,250 million of 2-year notes to refund $8,356 million of 2-year notes maturing August 31, 1985, and to raise about $900 million new cash. The $8,356 million of maturing 2-year notes are those held by the public, including $787 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $9,250 million is being offered to the public, and any amounts tendered by Federal Reserve Banks as agents for foreign and international monetary authorities will be added to that amount. Tenders for such accounts will be accepted at the average price of accepted competitive tenders.

In addition to the public holdings, Government accounts and Federal Reserve Banks, for their own accounts, hold $717 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.

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

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED SEPTEMBER 3, 1985

August 14, 1985

Amount Offered:

To the public	$9,250 million

Description of Security:

Term and type of security	2-year notes
Series and CUSIP designation	Series Y-1987 (CUSIP No. 912827 SQ 6)
Maturity date	August 31, 1987
Call date	No provision
Interest 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	February 28 and August 31
Minimum denomination available	$5,000

Terms of Sale:

Method of sale	Yield Auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None
Payment by non-institutional investors	Full payment to be submitted with tender
Payment through Treasury Tax and Loan (TT&L) Note Accounts	Acceptable for TT&L Note Option Depositaries
Deposit guarantee by designated institutions	Acceptable

Key Dates:

Receipt of tenders	Wednesday, August 21, 1985 prior to 1:00 p.m., EDST
Settlement (final payment due from institutions)	
a) cash or Federal funds	Tuesday, September 3, 1985
b) readily collectible check	Thursday, August 29, 1985

TREASURY NEWS
epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
August 16, 1985

CONTACT: Art Siddon
(202) 566-2041

TREASURY DEPARTMENT ISSUES STATEMENT ON FEDERAL "WATER'S EDGE" LEGISLATION

At its final meeting on May 1, 1984, the Worldwide Unitary Taxation Working Group agreed on three principles that should guide state taxation of the income of multinational corporations:

Principle 1: Water's edge unitary combination for both U.S. and foreign based companies.

Principle 2: Increased federal administrative assistance and cooperation with the states to promote full taxpayer disclosure and accountability.

Principle 3: Competitive balance for U.S. multinationals, foreign multinationals, and purely domestic businesses.

In a letter transmitting his report to the President as Chairman of the Working Group on July 31, 1984, then Treasury Secretary Regan stressed the importance of state action to limit use of the unitary method to the water's edge. "If there are not sufficient signs of appreciable progress by the states in this area by July 31 of next year, whether by legislation or administration action, I will recommend to you that the Administration propose federal legislation that would give effect to a water's edge limitation...."

The Treasury Department believes that in the past year there have been positive developments at the state level to implement the Working Group's recommendations. Specifically, Florida, Colorado, Indiana, Oregon, and Massachusetts have ceased taxing on a worldwide unitary basis. Utah has issued regulations that would terminate its use of the worldwide unitary method upon implementation of the federal assistance measures recommended by the Working Group. While California continues to tax on a worldwide unitary basis, water's edge legislation is currently receiving serious consideration in California.

On July 8 of this year, the Treasury Department issued for public comment proposed legislation that would provide federal administrative assistance to states that do not employ the worldwide unitary method. The release of this draft legislation, and the welcome developments that have occurred at the state level in the last year, indicate that the problems posed by the worldwide unitary method may be resolved this year. Accordingly, the Treasury is deferring consideration of whether to recommend federal water's edge legislation. In doing so, however, the Treasury Department acknowledges that important steps remain to be taken by the states before the unitary taxation problem can be considered to be satisfactorily resolved. The Treasury continues to urge that those states still taxing on a worldwide unitary basis adopt a water's edge limitation patterned after the Working Group's recommendations.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE August 19, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,209 million of 13-week bills and for $7,208 million of 26-week bills, both to be issued on August 22, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing November 21, 1985			:	26-week bills maturing February 20, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.10%a/	7.33%	98.205	:	7.27%b/	7.65%	96.325
High	7.15%	7.38%	98.193	:	7.30%	7.69%	96.309
Average	7.14%	7.37%	98.195	:	7.28%	7.66%	96.320

a/ Excepting 1 tender of $525,000.
b/ Excepting 1 tender of $50,000.

Tenders at the high discount rate for the 13-week bills were allotted 6%.
Tenders at the high discount rate for the 26-week bills were allotted 29%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 40,680	$ 40,680	:	$ 39,685	$ 39,685
New York	15,511,710	5,796,010	:	26,425,475	6,163,980
Philadelphia	32,355	32,355	:	24,425	23,715
Cleveland	48,970	48,970	:	44,545	34,345
Richmond	57,695	51,875	:	64,680	46,130
Atlanta	60,550	55,850	:	76,045	40,550
Chicago	1,005,995	360,905	:	942,960	168,210
St. Louis	74,025	54,025	:	91,075	49,575
Minneapolis	37,305	37,305	:	42,405	17,405
Kansas City	181,005	134,005	:	47,090	47,055
Dallas	44,310	39,310	:	36,320	26,320
San Francisco	1,135,775	246,635	:	1,693,220	197,280
Treasury	311,080	311,080	:	353,365	353,365
TOTALS	$18,541,455	$ 7,209,005	:	$29,881,290	$7,207,615
Type					
Competitive	$15,451,245	$ 4,118,795	:	$26,743,100	$4,069,425
Noncompetitive	1,139,600	1,139,600	:	1,047,890	1,047,890
Subtotal, Public	$16,590,845	$ 5,258,395	:	$27,790,990	$5,117,315
Federal Reserve	1,652,010	1,652,010	:	1,650,000	1,650,000
Foreign Official Institutions	298,600	298,600	:	440,300	440,300
TOTALS	$18,541,455	$ 7,209,005	:	$29,881,290	$7,207,615

1/ Equivalent coupon-issue yield.

B-247

TREASURY NEWS
Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
August 19, 1985

CONTACT: Art Siddon
(202) 566-2041

PAUL W. BATEMAN APPOINTED
DEPUTY TREASURER OF THE UNITED STATES

Treasury Secretary James A. Baker, III today announced the appointment of Paul W. Bateman to be Deputy Treasurer of the United States.

Mr. Bateman formerly was Deputy Assistant Secretary of Commerce for Economic Development. He has served at the Department of Commerce since 1982, initially as Executive Assistant to the Assistant Secretary for Economic Development, and was appointed Deputy Assistant Secretary in May 1984. From 1981 to 1982, he was employed at the White House as Deputy Director for Administrative Operations in the Office of Administration. He joined the White House staff after working for the Office of the President Elect during the 1980-1981, Presidential transition.

Prior to joining the Reagan Administration, Mr. Bateman was an assistant to former President Richard Nixon in San Clemente, California and later in New York City.

Mr. Bateman received his Bachelor of Arts degree from Whittier College in 1979. He was born February 28, 1957, and resides in the District of Columbia.

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TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. August 20, 1985

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued August 29, 1985. This offering will provide about $325 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $14,072 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, August 26, 1985. The two series offered are as follows:

92-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated November 29, 1984, and to mature November 29, 1985 (CUSIP No. 912794 HP 2), currently outstanding in the amount of $15,556 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,200 million, to be dated August 29, 1985, and to mature February 27, 1986 (CUSIP No. 912794 JU 9).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing August 29, 1985. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,150 million as agents for foreign and international monetary authorities, and $2,720 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. August 20, 1985

TREASURY TO AUCTION $7,250 MILLION
OF 5-YEAR 2-MONTH NOTES

The Department of the Treasury will auction $7,250 million of 5-year 2-month notes to raise new cash. Additional amounts of the notes may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities at the average price of accepted competitive tenders.

Details about the new security are given in the attached highlights of the offering and in the official offering circular.

Attachment

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B-250

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 5-YEAR 2-MONTH NOTES
TO BE ISSUED SEPTEMBER 3, 1985

August 20, 1985

Amount Offered:

To the public	$7,250 million

Description of Security:

Term and type of security	5-year 2-month notes
Series and CUSIP designation	Series M-1990 (CUSIP No. 912827 SR 4)
Maturity date	November 15, 1990
Call date	No provision
Interest 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	May 15 and November 15 (first payment on May 15, 1986)
Minimum denomination available	$1,000

Terms of Sale:

Method of sale	Yield Auction
Competitive tenders	Must be expressed as an annual yield, with two decimals, e.g., 7.10%
Noncompetitive tenders	Accepted in full at the average price up to $1,000,000
Accrued interest payable by investor	None
Payment by non-institutional investors	Full payment to be submitted with tender
Payment through Treasury Tax and Loan (TT&L) Note Accounts	Acceptable for TT&L Note Option Depositaries
Deposit guarantee by designated institutions	Acceptable

Key Dates:

Receipt of tenders	Wednesday, August 28, 1985, prior to 1:00 p.m., EDST
Settlement (final payment due from institutions)	
a) cash or Federal funds	Tuesday, September 3, 1985
b) readily collectible check	Thursday, August 29, 1985

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE

August 21, 1985

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $9,256 million of $19,282 million of tenders received from the public for the 2-year notes, Series Y-1987, auctioned today. The notes will be issued September 3, 1985, and mature August 31, 1987.

The interest rate on the notes will be 8-7/8%. The range of accepted competitive bids, and the corresponding prices at the 8-7/8% interest rate are as follows:

	Yield	Price
Low	8.86%	100.027
High	8.91%	99.937
Average	8.89%	99.973

Tenders at the high yield were allotted 100%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 72,490	$ 65,490
New York	16,782,010	7,694,360
Philadelphia	43,100	43,100
Cleveland	111,080	111,080
Richmond	108,355	98,355
Atlanta	93,585	92,535
Chicago	890,665	362,665
St. Louis	146,890	128,890
Minneapolis	52,185	52,185
Kansas City	158,080	157,580
Dallas	34,285	34,285
San Francisco	783,285	409,285
Treasury	6,210	6,210
Totals	$19,282,220	$9,256,020

The $9,256 million of accepted tenders includes $1,107 million of noncompetitive tenders and $8,149 million of competitive tenders from the public.

In addition to the $9,256 million of tenders accepted in the auction process, $345 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $717 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities.

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TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 12:00 NOON August 23, 1985

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $8,750 million of 364-day Treasury bills to be dated September 5, 1985, and to mature September 4, 1986 (CUSIP No. 912794 KQ 6). This issue will provide about $ 300 million of new cash for the Treasury, as the maturing 52-week bill is outstanding in the amount of $8,442 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Thursday, August 29, 1985.

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.

The bills will be issued for cash and in exchange for Treasury bills maturing September 5, 1985. In addition to the maturing 52-week bills, there are $14,072 million of maturing bills which were originally issued as 13-week and 26-week bills. The disposition of this latter amount will be announced next week. Federal Reserve Banks currently hold $2,037 million as agents for foreign and international monetary authorities, and $5,373 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rate 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. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $235 million of the original 52-week issue. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-1.

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE August 26, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,220 million of 13-week bills and for $7,223 million of 26-week bills, both to be issued on August 29, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing November 29, 1985			26-week bills maturing February 27, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	7.05%	7.28%	98.198	7.20%	7.58%	96.360
High	7.08%	7.31%	98.191	7.22%	7.60%	96.350
Average	7.07%	7.30%	98.193	7.21%	7.59%	96.355

Tenders at the high discount rate for the 13-week bills were allotted 98%.
Tenders at the high discount rate for the 26-week bills were allotted 75%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 57,675	$ 37,675	$ 63,400	$ 39,400
New York	15,916,250	6,041,780	15,772,075	4,731,325
Philadelphia	22,025	22,025	26,625	26,625
Cleveland	53,910	53,910	34,165	33,870
Richmond	62,135	52,135	59,650	52,150
Atlanta	47,755	42,725	55,590	40,090
Chicago	1,071,955	198,335	1,486,930	401,305
St. Louis	72,910	52,875	91,735	55,485
Minneapolis	42,025	42,005	40,185	33,935
Kansas City	139,675	87,155	54,900	53,150
Dallas	48,175	43,175	32,395	26,145
San Francisco	1,235,060	271,440	2,250,485	1,392,690
Treasury	275,045	275,045	336,895	336,895
TOTALS	$19,044,595	$7,220,280	$20,305,030	$7,223,065
Type				
Competitive	$16,338,680	$4,514,365	$17,291,510	$4,209,545
Noncompetitive	1,054,030	1,054,030	968,520	968,520
Subtotal, Public	$17,392,710	$5,568,395	$18,260,030	$5,178,065
Federal Reserve	1,373,385	1,373,385	1,350,000	1,350,000
Foreign Official Institutions	278,500	278,500	695,000	695,000
TOTALS	$19,044,595	$7,220,280	$20,305,030	$7,223,065

1/ Equivalent coupon-issue yield.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M.

August 27, 1985

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued September 5, 1985. This offering will provide about $325 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $14,072 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Tuesday, September 3, 1985. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated June 6, 1985, and to mature December 5, 1985 (CUSIP No. 912794 JH 8), currently outstanding in the amount of $7,022 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,200 million, to be dated September 5, 1985, and to mature March 6, 1986 (CUSIP No. 912794 JV 7).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing September 5, 1985. In addition to the maturing 13-week and 26-week bills, there are $8,442 million of maturing 52-week bills. The disposition of this latter amount was announced last week. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $1,822 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $2,057 million as agents for foreign and international monetary authorities, and $5,380 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
August 26, 1985

CONTACT: ART SIDDON
(202) 566-2041

RATIFICATION OF PROTOCOL TO U.S.-FRANCE INCOME TAX TREATY AND STATUS OF CERTAIN ESTATE AND GIFT TAX TREATIES

The Treasury Department today announced the exchange of instruments of ratification of the Protocol, signed on January 17, 1984, to the Convention Between the United States of America and the French Republic With Respect to Taxes on Income and Property. The original Convention, which was signed in 1967, was previously amended by two protocols signed in 1970 and 1978.

The exchange of instruments of ratification took place in Washington on August 23, 1985. The Protocol will enter into force on October 1, 1985. Its provisions shall apply as follows: in the case of taxes withheld at source, to amounts payable on or after October 1, 1985; in the case of other taxes on income, for taxable years beginning on or after October 1, 1985; and in the case of the French wealth tax, to capital owned on or any time after January 1, 1982.

The Treasury Department also announced the status of three estate and gift tax treaties to respond to frequent inquiries about them. The exchange of instruments of ratification of the Convention Between the United States of America and the Government of Sweden for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Estates, Inheritances, and Gifts, signed on June 13, 1983, took place on September 5, 1984, and the treaty took effect as of that date. The ratification procedures of the Convention Between the Government of the United States of America and the Government of the Kingdom of Denmark for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Estates, Inheritances, Gifts and Certain Other Transfers, signed on April 27, 1983, were completed on November 7, 1984, and the convention entered into force on that day. The exchange of instruments of ratification of the Convention Between the United States of America and the Government of the Federal Republic of Germany for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Estates, Inheritances, and Gifts, signed on December 3, 1980, has not yet taken place. It is anticipated that the German Government will approve the exchange of instruments of ratification in the near future.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
August 27, 1985

CONTACT: ART SIDDON
(202) 566-2041

TREASURY ANNOUNCES PENALTIES AGAINST CROCKER NATIONAL BANK

The Department of the Treasury today announced that Crocker National Bank has agreed to pay penalties of $2.25 million for a series of violations of the Bank Secrecy Act. The violations, which consisted of failures to file currency transactions reports for cash transactions exceeding $10,000, as required under the Act, were discovered following a compliance examination conducted by the Comptroller of the Currency. These violations, which totalled in excess of 7800, resulted from failures to report both international and domestic currency transactions.

In announcing the penalty, John M. Walker, Jr., Assistant Secretary for Enforcement and Operations, stated: "The penalties assessed against Crocker National Bank resulted from extensive noncompliance involving reporting failures at various bank units and branches going back to 1980. Although there is no evidence that the bank itself deliberately engaged in money laundering, Crocker's reporting failures were systemic and pervasive. They deprived Treasury of potentially important law enforcement leads that could have been useful in drug, tax, money laundering and other investigations. This case illustrates why full compliance with the Bank Secrecy Act is essential to effective law enforcement."

This is the largest civil penalty Treasury has ever imposed on a financial institution for Bank Secrecy Act violations. In June, penalties ranging in amounts of $210,000 to $360,000 were imposed against four New York banks. According to Mr. Walker, "The extremely serious nature of Crocker's violations warranted a substantially more severe penalty than in prior cases."

Mr. Walker added: "The systems failures that led to Crocker's reporting violations originated prior to the installation of Crocker's present management. After compliance problems were uncovered by the Comptroller of the Currency, Crocker's present management cooperated with Treasury in developing the scope of the bank's liability. Crocker has made a commitment to full compliance in the future. These elements, as well as the fact that the bank only recently returned to profitability after its well-known financial difficulties of recent years, were mitigating factors in the penalty determination."

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Crocker National Bank is the nation's fifteenth largest bank, with branches throughout California.

The Bank Secrecy Act requires that financial institutions report to Treasury within 15 days all currency transactions in excess of $10,000. These reports are computerized and then used by Treasury enforcement task forces in financial investigations directed against organized crime, drug trafficking, money laundering and tax evasion.

The Act carries civil and criminal penalties. Until the passage of the Comprehensive Crime Control Act in October, 1984, the maximum civil penalty was $1,000 per violation and the maximum criminal penalties were one-year imprisonment and a $1,000 fine, or both. The 1984 Act increased the criminal penalties to five years and $250,000 and the civil penalty to $10,000.

FACT SHEET

The $2.25 million civil penalty Treasury has assessed against Crocker National Bank is pursuant to the Bank Secrecy Act. It results from violations of the requirement to file with the IRS Currency Transaction Reports ("CTRs") for all cash transactions (e.g., deposits, disbursements, or transfers) exceeding $10,000, whether domestic or international.

The data included in the CTRs is collated and analyzed at the Treasury Financial Law Enforcement Center (FLETC) located at the headquarters of the U.S. Customs Service. The information generated is vital to the support of ongoing investigations and to the development of leads for new investigations into money laundering, tax evasion, and various organized crime offenses.

The Bank.

Crocker National Bank is the nation's fifteenth largest bank, with over 400 branches throughout the state of California. Since May of 1985, Crocker, through its holding company Crocker National Corporation (CNC), has been wholly owned by Midland Bank plc, which prior to that time had been a 57% shareholder in CNC. The financial restructuring occurred in response to a $324 million net loss in 1984, including a $216 million net loss in the fourth quarter of that year. Crocker has returned to profitability in 1985, with net income of $9 million in the first quarter and $10 million in the second.

Other Recent Penalty Cases Against Banks.

On February 7 of this year, the Bank of Boston agreed to pay a $500,000 civil penalty for 1163 violations of the Bank Secrecy Act reporting requirements involving transactions totalling $1.22 billion. The Bank also pleaded guilty to a felony charge in connection with the reporting violations.

Last June 18, Treasury announced civil penalties against four New York banks for failure to report currency transactions between 1980 and 1984. The four banks, the penalty amounts and the number of reporting failures were: Chase Manhattan Bank, $360,000 (1,442 reports); Manufacturers Hanover Trust Company, $320,000 (1,393 reports); Irving Trust Company, $295,000 (1,242 reports) and Chemical Bank, $210,000 (857 reports).

History of Treasury's Investigations Against Banks.

Since 1975, there have been 38 cases in which banks or employees of banks have been convicted of violations of financial reporting requirements. In 25 of these cases, the bank itself has been convicted; in 15 of them, bank officers and employees have been convicted.

Currently, there are approximately 100 open cases that have been referred to IRS for possible criminal prosecution involving financial institutions.

Since the Bank of Boston case, approximately 60 banks have come forward to disclose Bank Secrecy Act compliance problems to Treasury.

Results of the Federal Enforcement Effort Using Bank Secrecy Information. Treasury has used Bank Secrecy Act reporting information to destroy nineteen major money laundering organizations, which had collectively laundered approximately $3 billion in crime proceeds since 1980. In addition, the reporting data supports the investigations of the thirteen Organized Crime Drug Enforcement Task Forces (OCDE). These task forces, which became fully operational just over two years ago, have resulted in the indictment of 6316 individuals and 2537 convictions. Treasury's financial investigations, conducted by agents from IRS and Customs, play a major role in the work of the OCDE Task Forces.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. August 27, 1985

TREASURY OFFERS $3,000 MILLION OF 16-DAY CASH MANAGEMENT BILLS

The Department of the Treasury, by this public notice, invites tenders for approximately $3,000 million of 16-day Treasury bills to be issued September 3, 1985, representing an additional amount of bills dated March 21, 1985, maturing September 19, 1985 (CUSIP No. 912794 HZ 0).

Competitive tenders will be received at all Federal Reserve Banks and Branches prior to 12:00 noon, Eastern Daylight Saving time, Thursday, August 29, 1985. Wire and telephone tenders may be received at the discretion of each Federal Reserve Bank or Branch. Each tender for the issue must be for a minimum amount of $1,000,000. Tenders over $1,000,000 must be in multiples of $1,000,000. Tenders must show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions must not be used.

Noncompetitive tenders from the public will not be accepted. Tenders will not be received at the Department of the Treasury, Washington.

The bills will be issued on a discount basis under competitive bidding, and at maturity their par amount will be payable without interest. The bills will be issued entirely in book-entry form in a minimum denomination of $10,000 and in any higher $5,000 multiple, on the records of the Federal Reserve Banks and Branches. Additional amounts of the bills may be issued to Federal Reserve Banks as agents for foreign and international monetary authorities at the average price of accepted competitive tenders.

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 as of 11:30 a.m., Eastern time, on the day of the auction. Such positions would include bills acquired through "when issued" trading, futures,

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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.

No deposit need accompany tenders from incorporated banks and trust companies and from responsible and recognized dealers in investment securities. 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 yield range of accepted bids. Those submitting tenders 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. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923. Settlement for accepted tenders in accordance with the bids must be made or completed at the Federal Reserve Bank or Branch in cash or other immediately-available funds on Tuesday, September 3, 1985. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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 may be obtained from any Federal Reserve Bank or Branch.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE August 28, 1985

RESULTS OF AUCTION OF 5-YEAR 2-MONTH NOTES

The Department of the Treasury has accepted $7,254 million of $23,389 million of tenders received from the public for the 5-year 2-month notes, Series M-1990, auctioned today. The notes will be issued September 3, 1985, and mature November 15, 1990.

The interest rate on the notes will be 9-5/8%. The range of accepted competitive bids, and the corresponding prices at the 9-5/8% interest rate are as follows:

	Yield	Price
Low	9.61%	99.974
High	9.63%	99.894
Average	9.62%	99.934

Tenders at the high yield were allotted 16%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 66,391	$ 24,711
New York	20,095,327	6,368,423
Philadelphia	14,500	14,500
Cleveland	221,357	85,157
Richmond	95,390	31,330
Atlanta	46,701	23,501
Chicago	987,255	209,845
St. Louis	139,015	116,015
Minneapolis	41,043	32,443
Kansas City	70,774	68,674
Dallas	12,602	10,922
San Francisco	1,595,319	265,239
Treasury	2,845	2,845
Totals	$23,388,519	$7,253,605

The $7,254 million of accepted tenders includes $638 million of noncompetitive tenders and $6,616 million of competitive tenders from the public.

In addition to the $7,254 million of tenders accepted in the auction process, $560 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities.

THE TREASURER OF THE UNITED STATES
WASHINGTON, D.C. 20220

FOR IMMEDIATE RELEASE
August 30, 1985

CONTACT: Susanne Howard
566-2843

Grey Advertising Awarded Advertising Contract for Statue of Liberty Commemorative Coins

Washington, D.C.--Grey Advertising, Inc. of New York has been awarded the U.S. Treasury Department's advertising and public relations contract to promote the sale of the Statue of Liberty-Ellis Island Commemorative Coins, it was announced today by Katherine D. Ortega, Treasurer of the United States.

Under legislation signed by the President on July 9, 1985, the Treasury Department is authorized to mint and sell three legal tender coins to commemorate the 100th anniversary of the Statue of Liberty and to raise funds for the restoration and preservation of the Statue and Ellis Island. The coins authorized are a five dollar gold coin, a silver dollar, and a one-half dollar. The sales price of each coin contains an amount which goes to the Statue of Liberty-Ellis Island Foundation to assist with their restoration efforts.

"The goals of this program are to raise the greatest amount possible to assist with the restoration of two of America's greatest national monuments, and to provide the opportunity for all Americans to participate in this great national effort by purchasing the Statue of Liberty-Ellis Island Commemorative Coins," said Mrs. Ortega. "The selection of this advertising agency will help ensure achievement of these goals."

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Grey Advertising, New York's largest advertising agency was selected after an extensive competitive selection process, involving many of the largest agencies in the World.

In addition to the development and execution of national television and print advertising, the promotion campaign will involve Grey's marketing subsidiaries: Grey Direct, for direct marketing; Beaumont-Bennett, for sales promotion in retail outlets; and GreyCom for public relations.

The Treasury Department hopes to raise between $40 and $50 million in contributions to the Statue of Liberty-Ellis Island Foundation through the coin program.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-204

FOR IMMEDIATE RELEASE August 29, 1985

RESULTS OF TREASURY'S AUCTION OF 16-DAY CASH MANAGEMENT BILLS

Tenders for $3,004 million of 16-day Treasury bills to be issued on September 3, 1985, and to mature September 19, 1985, were accepted at the Federal Reserve Banks today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low	7.28%	7.42%	99.676
High	7.34%	7.46%	99.674
Average	7.31%	7.44%	99.675

Tenders at the high discount rate were allotted 78%.

TOTAL TENDERS RECEIVED AND ACCEPTED
BY FEDERAL RESERVE DISTRICTS:
(In Thousands)

Location	Received	Accepted
Boston	--	--
New York	$20,506,000	$2,704,000
Philadelphia	--	--
Cleveland	--	--
Richmond	10,000	--
Atlanta	--	--
Chicago	2,000,000	250,000
St. Louis	--	--
Minneapolis	--	--
Kansas City	--	--
Dallas	--	--
San Francisco	1,400,000	50,000
TOTALS	$23,916,000	$3,004,000

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE August 29, 1985

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $8,779 million of 52-week bills to be issued September 5, 1985, and to mature September 4, 1986, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	7.35%	7.90%	92.568
High -	7.37%	7.92%	92.548
Average -	7.36%	7.91%	92.558

Tenders at the high discount rate were allotted 39%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 35,385	$ 14,385
New York	20,526,560	8,149,960
Philadelphia	9,345	9,345
Cleveland	189,655	75,155
Richmond	36,760	16,760
Atlanta	70,440	13,390
Chicago	1,252,155	175,655
St. Louis	84,070	49,070
Minneapolis	12,555	11,945
Kansas City	33,750	28,140
Dallas	16,855	6,855
San Francisco	1,382,420	127,210
Treasury	101,335	101,335
TOTALS	$23,751,285	$8,779,205
Type		
Competitive	$21,100,000	$6,127,920
Noncompetitive	416,285	416,285
Subtotal, Public	$21,516,285	$6,544,205
Federal Reserve	2,000,000	2,000,000
Foreign Official Institutions	235,000	235,000
TOTALS	$23,751,285	$8,779,205

An additional $5,000 thousand of the bills will be issued to foreign official institutions for new cash.

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THE SECRETARY OF THE TREASURY
WASHINGTON

File Copy

August 31, 1985

Dear Dan:

On July 25th we issued a joint press release reaffirming our collective commitment to revenue neutrality as a firm underpinning of fundamental tax reform. The Staff of the Joint Committee on Taxation had on that day released its revenue estimates of the President's Tax Reform Proposals, which showed a $25.1 billion revenue shortfall over the 1986-1990 period, compared to an $11.6 billion shortfall as originally estimated by the Treasury Department. The Staff's report acknowledged that these two estimates are remarkably close, differing by less than one-half of one percent of estimated income tax receipts ($2.8 trillion during the 5-year period), and projecting an estimated revenue shortfall of less than one percent of estimated receipts. We have been working with the Joint Committee Staff to reach agreement on the amount of the shortfall, and although we believe that it will be somewhere between $20 billion and $25 billion, we have not yet reached final agreement.

The Administration remains of the view that a proposal that yields projected revenue within one percent of estimated receipts for the budget period constitutes a revenue neutral proposal, especially considering the inexactitude of the revenue estimating process. Thus it is our view that the President's proposals are "revenue neutral" within a reasonable margin of estimating error, even using the Joint Committee Staff's $25.1 billion estimate.

Nevertheless, in our July 25th press release we committed to offer further proposals to the tax-writing Committees to assure that the general public, as well as the Administration, perceives the President's proposals as revenue neutral. We recognize that to many people this means that the estimated revenue loss or gain must be closer to zero than plus-or-minus one percent.

So, in order that the estimated revenue loss be closer to zero, we would offer three possible modifications to the President's proposals. We make these suggestions only to comply with what is, we believe, an artificially exact definition of revenue neutrality. It is our judgment that the modifications suggested below, which total $22.9 billion, present the best available means to meet this requirement.

1. Eliminate indexation of inventories and retain LIFO conformity.

	1986	1987	1988	1989	1990	1986-90
			($ billions)			
Joint Committee Staff revenue estimate	--	1.7	3.0	3.2	3.3	11.1

2. Repeal Section 401(k) (cash or deferred defined contribution plans). See the enclosure for explanation.

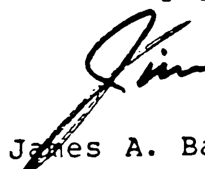
	1986	1987	1988	1989	1990	1986-90
			($ billions)			
Joint Committee Staff revenue estimate	.9	2.0	2.3	2.9	3.5	11.6

3. Retain child care credit; withdraw proposal to convert credit into a deduction.

	1986	1987	1988	1989	1990	1986-90
			($ billions)			
Joint Committee Staff revenue estimate	*	*	*	.1	.1	.2

We look forward to working with the tax-writing Committees to accomplish fundamental tax reform, which, as you know, is a top priority of the President. We believe that the President's proposals are the pathway to fundamental reform, and that deviations from that path should be made only for compelling reasons. Indeed, we cannot overstate the depth of the President's commitment to the reduction of tax rates contained in his May 28th proposals. It is my view that under no circumstances would he accept tax rates above those proposed by him. Increasing the rates he proposed is not an appropriate source of revenue to finance modifications to his original proposals.

Sincerely yours,



James A. Baker, III

The Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
U.S. House of Representatives
Washington, D.C. 20515

Enclosure

REPEAL CASH OR DEFERRED ARRANGEMENT (CODA) PROVISIONS

General Explanation

Current Law

In general, employees are subject to tax not only on compensation actually received but also on amounts the receipt of which is, at the employee's election, deferred until a later year. A statutory exception to this rule of constructive receipt is provided for so-called cash or deferred arrangements (CODAs), under which an employee may elect to defer the receipt of cash compensation and have the deferred amount contributed as an employer contribution to a qualified profit-sharing or stock bonus plan. If the CODA meets certain qualification requirements, the employee is not currently taxable on the deferred amount. Contributions to CODAs are subject to the limits that apply generally to defined contribution plans. Thus, if allowed under the special nondiscrimination test for CODAs, the maximum amount that may be contributed to a CODA on behalf of any individual is the lesser of $30,000 (indexed beginning in 1988) or 25 percent of the individual's compensation.

A CODA is qualified only if the deferred amounts (1) are wholly nonforfeitable, (2) may not be distributed to the employee before the earlier of age 59-1/2, separation from service, retirement, hardship, disability, or death, and (3) satisfy the "actual deferral percentage test" (the ADP test). In general, the ADP test is satisfied if the average percentage of compensation deferred for "highly compensated employees" does not exceed 150 percent of the average percentage deferred for other employees.

Deductible contributions to an individual retirement account (IRA) are currently limited to the lesser of $2,000 ($2,250 for a spousal IRA) or 100 percent of compensation. Individual contributions to an IRA receive the same tax-deferral advantages as deferred compensation under a CODA. Thus, subject to certain limits, an individual receives a deduction for contributions to an IRA, and is taxable on such amounts only as they are withdrawn from the IRA. Amounts withdrawn from an IRA prior to the individual's death, disability or reaching age 59 1/2 are subject to a 10 percent penalty.

Reasons for Change

The Federal government promotes individual retirement security both through direct outlays, such as those for social security, and, increasingly, through indirect outlays, in the form of tax-favored treatment for income saved for retirement

purposes. The revenues dedicated to the tax component of these Federal programs have grown significantly over time, with the revenue loss attributable to CODAs alone projected to double in the next four years. These lost revenues necessitate higher rates of tax on other income, which, in turn, create disincentives for savings and investment throughout the economy.

Despite the substantial revenue costs attributable to the tax incentives provided for retirement savings, a broad political and policy consensus supports their continuation. The Administration's tax reform proposals reflect this support, and would not alter the basic structure under which certain income set aside for retirement purposes is exempt from tax until distributed. At the same time, there is legitimate concern over the growth in savings plans that receive tax advantages and the consequent erosion of the tax base. Ultimately, continued support for tax-favored retirement savings will depend on how efficiently the available tax incentives promote individual retirement security. The long-term viability of tax-favored retirement savings thus requires that tax incentives be targeted at plans that most directly serve retirement policy objectives.

Although CODAs are, perhaps, the fastest growing form of tax-favored savings plan, they are a relatively poor retirement savings vehicle. Because CODA contributions are elective with employees, CODAs tend to be viewed as an alternate form of savings account, which may be drawn upon for nonretirement purposes, just as with other voluntary savings. Current law encourages this perception by permitting employees to withdraw CODA amounts prior to retirement in the event of financial need. Although the penalties currently applicable to pre-retirement IRA distributions might be extended to CODAs, there would be inevitable pressures to provide exceptions. It is illustrative that a number of bills are pending in Congress that would permit penalty-free withdrawals from IRAs for purposes such as the purchase of a first residence or to pay the costs of a child's education. Such proposals undermine the retirement policy objectives of tax-favored savings plans, and, indeed, reflect the perception that discretionary savings plans, such as an IRA or CODA, are not strictly retirement savings vehicles.

CODAs are also less effective than other retirement savings plans in ensuring broad employee coverage. Since each employee must decide whether and how much to contribute, CODAs inevitably result in uneven levels of retirement savings, and no savings at all for some employees. Moreover, the problem of uneven coverage is not eliminated simply by tightening the existing CODA nondiscrimination rules. Nondiscrimination rules for discretionary savings plans are necessarily based on average utilization levels, which may reflect maximum utilization by some employees and minimal or no utilization by others.

The defects in CODAs as retirement savings vehicles are in part responsible for the rapid growth in their availability and

use. Employees unwilling to defer salary until retirement may contribute to a CODA, knowing that the money is available if needed. Some would thus argue that CODAs should be encouraged because they result in additional savings by employees. This argument ignores, however, that tax advantages are extended to savings plans in order to advance retirement policy objectives. Given their revenue costs, CODAs cannot be justified as a general purpose savings vehicle. Moreover, to the extent it is appropriate to provide tax incentives for discretionary savings accounts, IRAs provide a vehicle that is available on a broader and more equitable basis.

Proposals

The provisions of the tax law authorizing CODAs would be repealed.

Effective Date

Repeal would be effective for contributions to a CODA on or after January 1, 1986.

Analysis

After repeal of the CODA provisions, the general constructive receipt rules of current law would apply with respect to employee cash or deferred elections. Thus, if an employee has the right to defer the receipt of some or all of his or her cash compensation and to have the deferred amount contributed to a tax-favored retirement plan, the employee would be treated as having received the deferred amounts. This would be the case without regard to whether the employee's election was before or after the period in which the employee earned the compensation subject to the election. Thus, the deferred amount would be included in the employee's gross income and the contributions would be treated as after-tax contributions to the plan. Of course, such after-tax contributions may be deductible subject to the generally applicable IRA deduction limits.

THE SECRETARY OF THE TREASURY
WASHINGTON

August 31, 1985

Dear Bob:

On July 25th we issued a joint press release reaffirming our collective commitment to revenue neutrality as a firm underpinning of fundamental tax reform. The Staff of the Joint Committee on Taxation had on that day released its revenue estimates of the President's Tax Reform Proposals, which showed a $25.1 billion revenue shortfall over the 1986-1990 period, compared to an $11.6 billion shortfall as originally estimated by the Treasury Department. The Staff's report acknowledged that these two estimates are remarkably close, differing by less than one-half of one percent of estimated income tax receipts ($2.8 trillion during the 5-year period), and projecting an estimated revenue shortfall of less than one percent of estimated receipts. We have been working with the Joint Committee Staff to reach agreement on the amount of the shortfall, and although we believe that it will be somewhere between $20 billion and $25 billion, we have not yet reached final agreement.

The Administration remains of the view that a proposal that yields projected revenue within one percent of estimated receipts for the budget period constitutes a revenue neutral proposal, especially considering the inexactitude of the revenue estimating process. Thus it is our view that the President's proposals are "revenue neutral" within a reasonable margin of estimating error, even using the Joint Committee Staff's $25.1 billion estimate.

Nevertheless, in our July 25th press release we committed to offer further proposals to the tax-writing Committees to assure that the general public, as well as the Administration, perceives the President's proposals as revenue neutral. We recognize that to many people this means that the estimated revenue loss or gain must be closer to zero than plus-or-minus one percent.

So, in order that the estimated revenue loss be closer to zero, we would offer three possible modifications to the President's proposals. We make these suggestions only to comply with what is, we believe, an artificially exact definition of revenue neutrality. It is our judgment that the modifications suggested below, which total $22.9 billion, present the best available means to meet this requirement.

1. Eliminate indexation of inventories and retain LIFO conformity.

	1986	1987	1988	1989	1990	1986-90
			($ billions)			
Joint Committee Staff revenue estimate	--	1.7	3.0	3.2	3.3	11.1

2. Repeal Section 401(k) (cash or deferred defined contribution plans). See the enclosure for explanation.

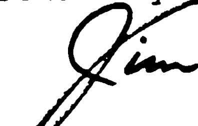
	1986	1987	1988	1989	1990	1986-90
			($ billions)			
Joint Committee Staff revenue estimate	.9	2.0	2.3	2.9	3.5	11.6

3. Retain child care credit; withdraw proposal to convert credit into a deduction.

	1986	1987	1988	1989	1990	1986-90
			($ billions)			
Joint Committee Staff revenue estimate	*	*	*	.1	.1	.2

We look forward to working with the tax-writing Committees to accomplish fundamental tax reform, which, as you know, is a top priority of the President. We believe that the President's proposals are the pathway to fundamental reform, and that deviations from that path should be made only for compelling reasons. Indeed, we cannot overstate the depth of the President's commitment to the reduction of tax rates contained in his May 28th proposals. It is my view that under no circumstances would he accept tax rates above those proposed by him. Increasing the rates he proposed is not an appropriate source of revenue to finance modifications to his original proposals.

Sincerely yours,



James A. Baker, III

The Honorable Bob Packwood
Chairman
Senate Finance Committee
United States Senate
Washington, D.C. 20510

Enclosure

REPEAL CASH OR DEFERRED ARRANGEMENT (CODA) PROVISIONS

General Explanation

Current Law

In general, employees are subject to tax not only on compensation actually received but also on amounts the receipt of which is, at the employee's election, deferred until a later year. A statutory exception to this rule of constructive receipt is provided for so-called cash or deferred arrangements (CODAs), under which an employee may elect to defer the receipt of cash compensation and have the deferred amount contributed as an employer contribution to a qualified profit-sharing or stock bonus plan. If the CODA meets certain qualification requirements, the employee is not currently taxable on the deferred amount. Contributions to CODAs are subject to the limits that apply generally to defined contribution plans. Thus, if allowed under the special nondiscrimination test for CODAs, the maximum amount that may be contributed to a CODA on behalf of any individual is the lesser of $30,000 (indexed beginning in 1988) or 25 percent of the individual's compensation.

A CODA is qualified only if the deferred amounts (1) are wholly nonforfeitable, (2) may not be distributed to the employee before the earlier of age 59-1/2, separation from service, retirement, hardship, disability, or death, and (3) satisfy the "actual deferral percentage test" (the ADP test). In general, the ADP test is satisfied if the average percentage of compensation deferred for "highly compensated employees" does not exceed 150 percent of the average percentage deferred for other employees.

Deductible contributions to an individual retirement account (IRA) are currently limited to the lesser of $2,000 ($2,250 for a spousal IRA) or 100 percent of compensation. Individual contributions to an IRA receive the same tax-deferral advantages as deferred compensation under a CODA. Thus, subject to certain limits, an individual receives a deduction for contributions to an IRA, and is taxable on such amounts only as they are withdrawn from the IRA. Amounts withdrawn from an IRA prior to the individual's death, disability or reaching age 59 1/2 are subject to a 10 percent penalty.

Reasons for Change

The Federal government promotes individual retirement security both through direct outlays, such as those for social security, and, increasingly, through indirect outlays, in the form of tax-favored treatment for income saved for retirement

purposes. The revenues dedicated to the tax component of these Federal programs have grown significantly over time, with the revenue loss attributable to CODAs alone projected to double in the next four years. These lost revenues necessitate higher rates of tax on other income, which, in turn, create disincentives for savings and investment throughout the economy.

Despite the substantial revenue costs attributable to the tax incentives provided for retirement savings, a broad political and policy consensus supports their continuation. The Administration's tax reform proposals reflect this support, and would not alter the basic structure under which certain income set aside for retirement purposes is exempt from tax until distributed. At the same time, there is legitimate concern over the growth in savings plans that receive tax advantages and the consequent erosion of the tax base. Ultimately, continued support for tax-favored retirement savings will depend on how efficiently the available tax incentives promote individual retirement security. The long-term viability of tax-favored retirement savings thus requires that tax incentives be targeted at plans that most directly serve retirement policy objectives.

Although CODAs are, perhaps, the fastest growing form of tax-favored savings plan, they are a relatively poor retirement savings vehicle. Because CODA contributions are elective with employees, CODAs tend to be viewed as an alternate form of savings account, which may be drawn upon for nonretirement purposes, just as with other voluntary savings. Current law encourages this perception by permitting employees to withdraw CODA amounts prior to retirement in the event of financial need. Although the penalties currently applicable to pre-retirement IRA distributions might be extended to CODAs, there would be inevitable pressures to provide exceptions. It is illustrative that a number of bills are pending in Congress that would permit penalty-free withdrawals from IRAs for purposes such as the purchase of a first residence or to pay the costs of a child's education. Such proposals undermine the retirement policy objectives of tax-favored savings plans, and, indeed, reflect the perception that discretionary savings plans, such as an IRA or CODA, are not strictly retirement savings vehicles.

CODAs are also less effective than other retirement savings plans in ensuring broad employee coverage. Since each employee must decide whether and how much to contribute, CODAs inevitably result in uneven levels of retirement savings, and no savings at all for some employees. Moreover, the problem of uneven coverage is not eliminated simply by tightening the existing CODA nondiscrimination rules. Nondiscrimination rules for discretionary savings plans are necessarily based on average utilization levels, which may reflect maximum utilization by some employees and minimal or no utilization by others.

The defects in CODAs as retirement savings vehicles are in part responsible for the rapid growth in their availability and

use. Employees unwilling to defer salary until retirement may contribute to a CODA, knowing that the money is available if needed. Some would thus argue that CODAs should be encouraged because they result in additional savings by employees. This argument ignores, however, that tax advantages are extended to savings plans in order to advance retirement policy objectives. Given their revenue costs, CODAs cannot be justified as a general purpose savings vehicle. Moreover, to the extent it is appropriate to provide tax incentives for discretionary savings accounts, IRAs provide a vehicle that is available on a broader and more equitable basis.

Proposals

The provisions of the tax law authorizing CODAs would be repealed.

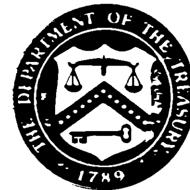
Effective Date

Repeal would be effective for contributions to a CODA on or after January 1, 1986.

Analysis

After repeal of the CODA provisions, the general constructive receipt rules of current law would apply with respect to employee cash or deferred elections. Thus, if an employee has the right to defer the receipt of some or all of his or her cash compensation and to have the deferred amount contributed to a tax-favored retirement plan, the employee would be treated as having received the deferred amounts. This would be the case without regard to whether the employee's election was before or after the period in which the employee earned the compensation subject to the election. Thus, the deferred amount would be included in the employee's gross income and the contributions would be treated as after-tax contributions to the plan. Of course, such after-tax contributions may be deductible subject to the generally applicable IRA deduction limits.

TREASURY NEWS



Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE September 3, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,208 million of 13-week bills and for $7,217 million of 26-week bills, both to be issued on September 5, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing December 5, 1985			:	26-week bills maturing March 6, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.09%a/	7.32%	98.208	:	7.29%	7.67%	96.315
High	7.14%	7.37%	98.195	:	7.31%	7.70%	96.304
Average	7.12%	7.35%	98.200	:	7.30%	7.69%	96.309

a/ Excepting 1 tender of $1,000,000.

Tenders at the high discount rate for the 13-week bills were allotted 39%.
Tenders at the high discount rate for the 26-week bills were allotted 44%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 69,340	$ 49,340	:	$ 70,720	$ 50,720
New York	14,194,960	5,965,730	:	17,299,625	5,975,060
Philadelphia	24,055	24,055	:	20,845	20,845
Cleveland	47,735	47,735	:	288,145	137,145
Richmond	49,595	49,595	:	72,910	65,110
Atlanta	40,160	39,160	:	60,620	43,260
Chicago	859,245	180,945	:	961,700	143,060
St. Louis	74,605	54,605	:	92,905	52,905
Minneapolis	40,140	40,140	:	48,350	34,350
Kansas City	162,290	162,290	:	61,535	61,535
Dallas	42,080	39,030	:	36,175	28,375
San Francisco	1,871,505	236,325	:	2,157,415	235,815
Treasury	318,895	318,895	:	368,745	368,745
TOTALS	$17,794,605	$7,207,845	:	$21,539,690	$7,216,925
Type					
Competitive	$14,876,225	$4,289,465	:	$18,043,205	$3,720,440
Noncompetitive	1,131,480	1,131,480	:	1,085,285	1,085,285
Subtotal, Public	$16,007,705	$5,420,945	:	$19,128,490	$4,805,725
Federal Reserve	1,776,100	1,776,100	:	1,750,000	1,750,000
Foreign Official Institutions	10,800	10,800	:	661,200	661,200
TOTALS	$17,794,605	$7,207,845	:	$21,539,690	$7,216,925

1/ Equivalent coupon-issue yield.

B-262

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. September 3, 1985

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued September 12, 1985. This offering will provide about $300 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $14,112 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, September 9, 1985. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated June 13, 1985, and to mature December 12, 1985 (CUSIP No. 912794 JJ 4), currently outstanding in the amount of $7,035 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $7,200 million, to be dated September 12, 1985, and to mature March 13, 1986 (CUSIP No. 912794 JW 5).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing September 12, 1985. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,079 million as agents for foreign and international monetary authorities, and $3,548 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS
epartment of the Treasury • Washington, D.C. • Telephone 566-204

FOR IMMEDIATE RELEASE
September 5, 1985

Contact: Art Siddon
Phone: (202) 566-5252

Secretary James A. Baker, III
Announces Sherrie M. Cooksey as Executive Secretary
for the Department of the Treasury

Secretary Baker today announced the appointment of Sherrie M. Cooksey to be Executive Secretary for the Department of the Treasury.

Mrs. Cooksey previously served as an Associate Counsel to the President. Prior to that position, she served as Special Assistant to the President for Legislative Affairs. Before joining the White House staff she worked at the Federal Elections Commission as Executive Assistant to the Commissioner and Chairman, Max L. Friedersdorf (1979-1981), and as an attorney in the Office of the General Counsel from 1977-1978. From 1978-1979 she was Minority (Republican) Counsel for Elections to the Senate Committee on Rules and Administration. During that same year, she served as a consultant to the Republican Senatorial campaigns of Senator John Warner of Virginia and former Senator Robert Griffin of Michigan.

Mrs. Cooksey graduated from the University of North Carolina (B.A., 1974), and from the University of North Carolina School of Law (J.D., 1977). She is married and resides in Alexandria, Virginia.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE   September 9, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,201 million of 13-week bills and for $7,205 million of 26-week bills, both to be issued on September 12, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing December 12, 1985			:	26-week bills maturing March 13, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.18%	7.41%	98.185	:	7.38% a/	7.77%	96.269
High	7.23%	7.47%	98.172	:	7.40%	7.79%	96.259
Average	7.22%	7.46%	98.175	:	7.39%	7.78%	96.264

a/ Excepting 1 tender of $125,000.

Tenders at the high discount rate for the 13-week bills were allotted 21%.
Tenders at the high discount rate for the 26-week bills were allotted 41%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 46,745	$ 46,745	:	$ 85,175	$ 45,175
New York	17,953,775	5,930,810	:	20,385,590	6,045,515
Philadelphia	30,870	30,870	:	21,520	21,520
Cleveland	49,995	49,130	:	299,050	105,550
Richmond	62,575	53,455	:	83,560	52,085
Atlanta	57,605	51,605	:	89,855	47,705
Chicago	1,372,105	332,515	:	1,209,980	229,055
St. Louis	67,800	27,800	:	99,310	59,310
Minneapolis	49,745	49,745	:	46,650	31,900
Kansas City	167,430	98,680	:	61,375	61,375
Dallas	42,415	33,465	:	30,770	20,770
San Francisco	1,094,170	190,170	:	1,106,100	84,235
Treasury	306,100	306,100	:	400,400	400,400
TOTALS	$21,301,330	$7,201,090	:	$23,919,335	$7,204,595
Type					
Competitive	$17,910,350	$3,810,110	:	$20,594,970	$3,880,230
Noncompetitive	1,156,250	1,156,250	:	1,159,365	1,159,365
Subtotal, Public	$19,066,600	$4,966,360	:	$21,754,335	$5,039,595
Federal Reserve	1,824,730	1,824,730	:	1,800,000	1,800,000
Foreign Official Institutions	410,000	410,000	:	365,000	365,000
TOTALS	$21,301,330	$7,201,090	:	$23,919,335	$7,204,595

1/ Equivalent coupon issue yield.

B-265

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE ON DELIVERY
EXPECTED AT 9:00 A.M.
September 10, 1985

STATEMENT OF JOHN J. NIEHENKE
ACTING ASSISTANT SECRETARY OF THE TREASURY
(DOMESTIC FINANCE)
BEFORE THE SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE SENATE FINANCE COMMITTEE

Mr. Chairman and Members of the Committee:

My purpose here today is to advise you of the need for Congressional action to increase the public debt limit and to provide additional authority to issue long-term marketable Treasury bonds.

Debt Limit

Our immediate need is for legislation to increase the debt limit.

Our current cash and debt projections indicate that the present debt limit of $1,823.8 billion should be adequate to meet the Treasury's needs until September 30. Without an increase in the debt limit by that date, investment of the Civil Service Retirement and Disability Fund in Treasury securities will have to be delayed to avoid exceeding the debt limit. Then, on October 1, investment of the Military Retirement Fund and, on October 3, the Federal Supplementary Medical Insurance Trust Fund will have to be delayed. Without action on the debt limit, the combined interest losses to these three funds will be about $8 million a day. Also, a delay in debt limit legislation beyond September 30 will require

the Treasury to disrupt its scheduled market borrowings, which could add significantly to the cost of financing the debt.

Our current estimates show the debt subject to limit at $1,840.6 billion on September 30, 1985 and $2,073.4 billion on September 30, 1986, assuming a $20 billion cash balance on those dates. Given these projected debt levels, and allowing a $5 billion margin for contingencies, we request that the debt limit be increased to $1,845.6 billion through September 30, 1985 and $2,078.4 billion through September 30, 1986.

The budget resolution adopted by Congress on August 1 contains debt limit figures of $1,847.8 billion for fiscal year 1985, which is $2.2 billion above our request, and $2,078.7 billion for fiscal year 1986, which is $.3 billion above our request. Thus, the debt figures in the Congressional budget resolution are adequate to meet our estimated needs. These figures are incorporated in H.J. Res. 372, as passed by the House.

Timely action on the debt ceiling is essential to avoid a repetition of past dislocations which have hampered Treasury financing operations. In recent years, delays in action on the debt limit have generated market uncertainty about Treasury financing schedules and on several occasions costly emergency measures have been undertaken, including suspension of savings bond sales, cancellation of scheduled security auctions and failure to invest trust funds.

Finally, prompt action on the debt limit bill is absolutely essential to permit the Government to pay its bills. If the debt limit is not increased, the Government will be unable to meet all of its essential obligations when they fall due -- social security checks, payroll checks, unemployment checks, defense contracts, and principal and interest on its securities.

Long-Term Bonds

Now, I would like to advise you of our need for additional authority to issue marketable Treasury bonds.

The maximum interest rate that the Treasury may pay on marketable bonds (securities with maturities in excess of 10 years) has long been limited by law to 4-1/4 percent. This limit did not become a serious obstacle to Treasury issues of new bonds until the mid-1960's. At that time market rates of interest rose above 4-1/4 percent and the Treasury was precluded from issuing new bonds. The average length of the privately-held marketable debt of the Treasury declined steadily from 5-3/4 years in mid-1965 to about 2-1/2 years in 1975, because of the heavy reliance by the Treasury on short-term bill financing of the budget deficits during this period.

In 1971, Congress authorized the Treasury to issue a limited amount of bonds without regard to the 4-1/4 percent ceiling. The dollar limit since has been increased from time to time, most recently on May 25, 1984, when the limit was raised by $50 billion (from $150 billion to $200 billion) to accommodate additional

long-term financing. Assuming continuation of our recent pattern of long bond issuance, the existing $200 billion authority will be exhausted early in calendar 1986.

Since 1975 the Treasury's debt extension policies have moved the average length of the marketable debt from 2 years, 5 months in January 1976 to 4 years, 10 months in July, 1985, thus broadening the market for Treasury securities and reducing the administrative burden and market-disrupting effects of frequent Treasury operations to refund maturing issues. Yet while the Treasury has significantly improved the maturity structure of the debt in recent years, more than half of outstanding marketable debt matures within two years. This refunding requirement must be added to Treasury's new cash borrowing requirement to meet Treasury's total needs in the market. Because of the short average maturity of outstanding Treasury debt, long bond issuance must remain an integral part of Treasury's debt management policy.

We believe the 4-1/4 percent ceiling should be repealed. This Administration abhors interest rate ceilings as ineffective attempts to control prices and incompatible with our commitment to a free market pricing system. We view the interest rate ceiling on marketable bonds as an anachronism which serves only to frustrate the efficient management of the public debt. Removal of the 4-1/4 percent ceiling on Treasury marketable bonds will help the Treasury meet its financing needs in an efficient, cost-effective manner.

If the interest rate ceiling on long bonds is not abolished, as we believe it should be, we would request an increase in long bond authority of $50 billion, from $200 billion to $250 billion, which would be sufficient to carry us through 1986.

While legislative action on the long bond authority will be necessary to enable us to continue our recent pattern of long bond issuance through 1986, in the interest of expediting action on the debt limit, we would urge the Senate to adopt H.J. Res. 372 without amendment.

That concludes my prepared statement, Mr. Chairman. I will be happy to respond to your questions.

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TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

For Release Upon Delivery
Expected at 2:00 p.m., E.D.T.
September 9, 1985

STATEMENT OF
DENNIS E. ROSS
DEPUTY TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON SAVINGS,
PENSIONS, AND INVESTMENT POLICY
OF THE SENATE COMMITTEE ON FINANCE

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to discuss the Treasury Department's views on the appropriate tax treatment of employer-maintained plans to provide retired employees with health benefits. In the context of that discussion, I wish also to report on the present status of the study, mandated in the Tax Reform Act of 1984 (the "1984 Act"), of the various tax and benefit issues relating to post-retirement health benefits.

I would like to begin my testimony with a description of the tax principles applicable to plans to provide active and retired employees with health benefits. With that as background, I wish to discuss the changes enacted in the 1984 Act, together with some of the issues that remain to be addressed concerning prefunded post-retirement health benefits.

General Tax Principles

The tax law generally requires an employee to include in income all compensation received during the year for services performed for the employer, including wages, commissions, property, and other in-kind benefits. Compensation paid in the form of certain in-kind benefits, however, may be excluded from gross income if provided under qualifying employer-maintained plans, including profit-sharing, pension, and health plans.

On the employer's side, a deduction is permitted for ordinary and necessary business expenses paid or incurred during a taxable year, including a reasonable allowance for employee compensation. "Compensation" includes ordinary and necessary amounts paid with respect to a health plan. As a general matter, the year in which an employer is permitted to deduct compensation, whether as cash or in-kind benefits, corresponds to the year in which the employees include (or, but for an exclusion, would include) the compensation in income. Moreover, if an employer prefunds future compensation by establishing a reserve, income on the reserve is taxable to the employer.

In certain circumstances, an employer may be eligible for more favorable treatment for reserves for future compensation and benefits. In such cases, the employer is allowed a current deduction for contributions to a reserve to prefund future compensation or benefits, and the reserve is permitted to grow on a tax-exempt basis. With respect to cash compensation, favorable treatment generally is available only with respect to profit-sharing and pension plans that comply with various qualification rules, including nondiscrimination rules and minimum standards relating to participation, vesting, benefit accrual, and funding.

Prior to the 1984 Act, favorable tax treatment was also available for compensatory health benefits provided through welfare benefit funds, including voluntary employees' beneficiary associations ("VEBAs") and certain arrangements maintained by insurance companies for the benefit of employers (i.e., retired lives reserves). Although the favorable tax treatment of such funds was the same as that available to qualified retirement plans, welfare benefit funds were not required to satisfy the minimum standards applicable to qualified plans. (See the following section for a discussion of the 1984 Act as it relates to post-retirement health benefits.)

Although the tax treatment of welfare benefit funds was changed in the 1984 Act, employers remain able to prefund post-retirement health benefits on a tax-favored basis through contributions to a separate reserve account maintained in conjunction with a qualified pension or annuity plan. (Section 401(h) of the Code.) Generally, such health benefits, when added to any life insurance provided under the pension or annuity plan, must be subordinate to the retirement benefits provided under the plan. This means that the contributions made to the plan to provide health benefits and life insurance may not exceed 25 percent of the total contributions to the plan (other than contributions to provide past service credits). Amounts set aside in a separate account to provide post-retirement medical benefits may not revert to the employer or be used for any other

purpose before the satisfaction of all liabilities to provide health benefits. Finally, the health plan must satisfy certain nondiscrimination rules.

The Tax Reform Act of 1984

The 1984 Act adopted rules that, with limited exceptions for post-retirement life and health benefits, subject an employer using a welfare benefit fund, such as a VEBA, to the general tax principles applicable to compensation and benefits outside of the area of qualified pension and profit-sharing plans: no current deduction for contributions to provide future benefits and no tax-free accumulation of reserves. Congress thus sought to limit the extent to which employers, by virtue of the favorable tax treatment for welfare benefit funds, could shift the cost of the benefits to the Federal government.

In the case of post-retirement health benefits, the 1984 Act provides that an employer may deduct contributions to accumulate, no more rapidly than over its employees' years of service, an actuarially justified reserve to provide retired employees with health benefits. In calculating the actuarial reserve for post-retirement health benefits, the rules prohibit consideration of projected increases in the current cost and level of such benefits provided to retirees. In addition, the funds set aside for post-retirement health benefits are not permitted to grow on a tax-exempt basis; rather, the income of these funds is subject to the unrelated business income tax. In effect, an employer is permitted a deduction for contributions to a taxable, rather than a tax-exempt, trust to prefund post-retirement health benefits.

Many have characterized the 1984 Act limits on tax-favored prefunding as merely "anti-abuse" rules, concerned with preventing such situations as a corporation excessively overfunding a VEBA or using a VEBA primarily for the benefit of its key employees. Although the 1984 Act did adopt rules directed at the "abusive" use of VEBAs and other funds, the new rules attempt more broadly to conform the tax treatment of employers maintaining welfare benefit funds to the actual economic cost of the benefits provided. In this respect, the limits on tax-favored prefunding are consistent with the various provisions in the 1984 Act that apply "time value of money" concepts to the amount and timing of income and deductions. Indeed, the welfare benefit rules are very similar to the rules that permit limited employer deductions for contributions to taxable reserves for future nuclear power decomissioning and mine reclamation expenses.

An additional concern reflected in the 1984 Act is that tax advantages not be provided for prefunded welfare benefits unless the promised benefits are specifically defined and the employer's

liability for the benefits is legally fixed. Because post-retirement health benefits generally are not subject to statutory accrual or vesting provisions, it is not possible to fix the future benefits to which employees have accrued rights or the future liability for which the employer should be permitted to prefund.

Study of Post-Retirement Health Benefits

Congress' concern that tax advantages not be permitted for prefunded post-retirement health benefits absent proper accrual, vesting, and similar rules was additionally reflected in its request that the Treasury Department study the funding of welfare benefit plans and the need for minimum participation, benefit accrual, vesting, and funding standards similar to those applicable to qualified retirement plans. Our study, which we have undertaken with the Department of Labor, has not been completed. Although we are thus unprepared to offer specific recommendations or conclusions, I would like to discuss in general terms the tax and health policy issues on which we have focused.

Adequacy of Funding and Benefits. A necessary threshold issue for our study is whether the existing structure of public and private retirement security programs is adequate, in regard to both the aggregate benefits and the mix between cash and in-kind benefits. Although we have not concluded our analysis, any argument for additional public support in this area must be examined in light of the existing constraints on the Federal budget. In the same vein, the creation of new or expanded tax incentives would contradict current efforts to reform the tax system. The Administration's tax reform proposals would expand the base of taxable income in order to make the tax system fairer and reduce marginal tax rates. Although the proposals would retain basic incentives for retirement savings, the purposes of tax reform would be undermined by the extension of similar incentives to post-retirement health benefits.

A related issue is whether existing plans for post-retirement health benefits are adequately funded. Very few employers were prefunding post-retirement health benefits before the 1984 Act and very few are currently prefunding such benefits, even though limited tax-favored prefunding continues to be possible under a qualified pension plan. Many employers view post-retirement health benefits as discretionary, and believe they retain the right to reduce or terminate post-retirement health benefits for both retired and active employees. Employers may fear that prefunding would restrict their ability to reduce or eliminate currently envisioned post-retirement health benefits, not merely for current retirees (as some courts have already held), but also for future retirees. In any case, recent estimates of the

Department of Labor indicate that the present value of employers' unfunded liability for currently envisioned post-retirement health benefits is well in excess of $100 billion.

Structure of Benefit Plans. Our study has also considered how prefunded post-retirement health benefit plans should be structured. For example, under a defined contribution approach, the employer would contribute amounts to individual accounts maintained to provide post-retirement health benefits. After retirement, the amounts accumulated in an individual's account would be used to provide health benefits. Under a defined health benefit approach, the employer would prefund amounts sufficient to provide retirees with a specified type and level of health coverage. Under a defined dollar benefit approach, the employer would prefund amounts sufficient to provide retirees with a specified annual dollar benefit that would be used to provide health coverage; this approach would be substantially equivalent to the existing defined benefit retirement plan system under which retired employees generally receive specified annual dollar amounts.

Each of these approaches to the prefunding of post-retirement health benefits raises significant issues. Under both the defined contribution and the defined dollar benefit approaches, there may not be sufficient funds accumulated for an employee to maintain his preretirement type and level of health benefits. At the same time, the defined contributions and dollar benefit approaches permit an employer to control its costs by modifying the type and level of health coverage provided to retirees. Furthermore, these approach could be developed as modifications of existing defined benefit or money purchase pension plans; in effect, some portion of a retiree's annual benefit under a defined benefit retirement plan or contribution under a money purchase pension plan would be dedicated to the provision of retiree health coverage.

Under the defined health benefit approach, it would be necessary to project the future cost of the promised health benefits in order to calculate the appropriate levels of prefunding. Such projection is difficult because of the need to consider medical care inflation, increases and decreases in medical utilization, and cost shifting from Medicare. Moreover, absent regular accrual and vesting of benefits, actuarial assumptions have a dramatic impact on the reliability of future cost predictions. For example, if an employee accrues and vests-in the full post-retirement health benefit only by attaining age 55 and completing ten years of service, the preretirement turnover assumption becomes an important variable.

The defined health benefit approach also makes cost control more difficult because of the employer's commitment to a certain type and level of health benefits. Thus, it would presumably be necessary to restrict an employer's ability to reduce or

eliminate promised health benefits, even though changes in medical utilization or practice could make such reductions appropriate cost containment measures.

Although I should again state that our analysis in this area is incomplete, we currently are most interested in the defined dollar benefit approach. This approach would eliminate much of the uncertainty associated with projecting future medical costs and would not restrict modifications in the type and level of health benefits to adjust for changes in medical utilization and practices. In addition, because it promises a benefit measured in dollars, the defined dollar benefit approach would facilitate partial vesting and the portability of benefits.

The defined dollar benefit approach also raises the question of whether existing defined benefit pension plans can or should be modified to permit the payment of a portion of a retiree's annual dollar benefit in the form of health coverage. Separate funding for post-retirement health benefits may not be appropriate if they are regarded as simply another form of post-retirement deferred compensation. Such use of retirement savings to fund health benefits, however, could adversely affect retirees who are not receiving significant annual dollar benefits. Although health benefits cost the same dollar amount for each retiree, pension benefits are wage-related. It thus may be inappropriate to convert a significant portion of a retiree's annual benefit from cash into health coverage.

It will also be important to consider whether, under the defined dollar benefit approach, existing funds that have been set aside to provide pension benefits should be available to provide post-retirement health benefits. Indeed, some have argued that permitting an employer to use excess pension funds to provide post-retirement health benefits would both resolve some of the policy concerns that have recently been raised about asset reversions from defined benefit plans and, at the same time, enable an employer to reduce its unfunded post-retirement health liability.

Minimum Standards. We are also studying whether minimum participation, benefit accrual, vesting, and funding standards are necessary if favorable treatment is provided for post-retirement health benefits. The necessary frame of reference for this issue is, of course, the participation, accrual, vesting, and funding standards imposed by the Employee Retirement Income Security Act of 1974 ("ERISA") on employer-maintained retirement plans. The basic premises of ERISA are that an employer's pension promise must be specifically defined and adequately funded, and employees must accrue and vest in pension benefits in accordance with reasonable minimum standards. If any of these elements is not satisfied, ERISA effectively provides that an employer may not make the pension promise.

Although we believe the basic logic of ERISA would properly apply to the extent tax advantages are provided for post-retirement health benefits, certain of the ERISA requirements may not be readily transferable to the area of health benefits. In particular, if the promised health benefit is a type or level of health coverage, should employees accrue rights to post-retirement health benefits over a specified number of years or merely in a single year (e.g., the year of retirement)? Should graded or cliff vesting schedules be permitted, and in either case what is the slowest vesting schedule that an employer may adopt? Finally, to what extent should an employer be permitted (or required) to modify the nature of the health coverage provided under the plan, e.g., to control costs or take into account changes in medical utilization or practice?

As discussed above, it appears to us that a defined dollar benefit approach fits more readily with ERISA-type standards for accrual and vesting, and would avoid the conflict between cost control modifications and the employer's commitment to a specific type and level of coverage. The design of appropriate minimum standards thus requires that we first define the exact nature and form of the benefit promise to which employees accrue rights.

Conclusion

In closing, I would like to reaffirm that the Treasury Department is pleased to play a role in the study of post-retirement health benefits. The questions raised in this area involve fundamental issues of retirement and health policy, and should properly be subject to examination on a regular basis. Although significant work remains to be done, we have received useful input from many parties, including employer and employee representatives, representatives of insurance companies and consulting companies, and health economists and other experts. We welcome this aid, as well as the assistance and and cooperation of the Department of Labor.

General Information Relating to Post-Retirement Health Benefits

1. Most employers have not yet focused on the question of post-retirement health benefits. Less than one-half of the large employers have analyzed the long-term financial impact of their post-retirement health plans. Most of those that have not plan to do so in the near future. Recent growing interest in post-retirement health benefits may be attributed to an increasing retiree population, rising health care costs for the elderly, increasing recognition of the employers' potential liability, and potential changes in the accounting rules.

2. Most retirees are not covered under employer-maintained health plans. In 1983, about 30 percent of all retirees 65 years and older was covered in such health plans.

3. Most large employers permit retiring employees to continue coverage under their health plans for active employees. In some cases, however, coverage terminates at age 65, when Medicare coverage commences. Larger companies are more likely to provide post-retirement health benefits than are smaller companies. Post-retirement dental coverage is much less prevalent than post-retirement health coverage, and post-retirement vision care is rare.

4. Employers that provide post-retirement health benefits after age 65 generally continue the same coverage provided to active employees until the retiree becomes eligible for Medicare, and thereafter the employer will carve-out Medicare benefits or provide supplemental coverage for health expenses not reimbursed by Medicare. Under a "carve-out" approach, the employer-provided benefit is the health benefit provided to active employees less the amount actually reimbursed by Medicare. Under the Medicare supplement approach, the employer's plan provides health coverage (with their own deductibles and coinsurance) for expenses not covered by Medicare. Some employer plans pay the Medicare Part B premium for the retiree.

5. Post-retirement health plans cover the retiree's spouse and dependent children, generally until the spouse's death or remarriage and the attainment of a specified age by the dependent children.

6. About one-half of the post-retirement health plans are contributory. Between 10 and 15 percent of such plans require an employee contribution of more than 50 percent of the cost of the coverage.

7. Eligibility for post-retirement health benefits is typically tied to the retirement requirements of the employer's pension plan. Generally, these are the completion of (i) ten years of service and the attainment of age 55 or 60, or (ii) the attainment of age 65.

8. Virtually no employers prefund post-retirement health benefits. Surveys generally indicate that fewer than 5 percent of the respondents prefund post-retirement health benefits. Some of those that do prefund such benefits do so on a "termination funding" basis. Most employers provide post-retirement health benefits on a pay-as-you basis. This is the case even though prefunding was possible through VEBAs since about 1970 and continues to be possible under a qualified pension or annuity plan.

9. Most employers that provide post-retirement health benefits do not believe that they are legally obliged to continue such benefits for either current or future retirees. In several recent cases, however, particularly those involving union negotiated plans, courts have decided that employers do not have the unlimited right to reduce or terminate promised health benefits to current retirees. Indeed, in one case, the court concluded that an employer could not terminate promised health benefits for current retirees, even though the employer had reserved the right to terminate such benefits, because such benefits effectively vested upon retirement.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. September 10, 1985

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $14,400 million, to be issued September 19, 1985. This offering will result in a paydown for the Treasury of about $2,675 million, as the maturing bills total $17,080 million (including the 16-day cash management bills issued September 3, 1985, in the amount of $3,004 million). Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, September 16, 1985. The two series offered are as follows:

91-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated June 20, 1985, and to mature December 19, 1985 (CUSIP No. 912794 JK 1), currently outstanding in the amount of $7,033 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $7,200 million, representing an additional amount of bills dated March 21, 1985, and to mature March 20, 1986 (CUSIP No. 912794 JX 3), currently outstanding in the amount of $8,529 million, the additional and original bills to be freely interchangeable.

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.

The bills will be issued for cash and in exchange for Treasury bills maturing September 19, 1985. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,701 million as agents for foreign and international monetary authorities, and $3,799 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

B-268

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

Release Upon Delivery
Expected at 9:30 a.m., E.D.T.
September 11, 1985

STATEMENT OF
MIKEL M. ROLLYSON
TAX LEGISLATIVE COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT OF THE
COMMITTEE ON FINANCE OF THE
UNITED STATES SENATE

Mr. Chairman and Members of the Committee:

It is my pleasure to be here today to present the views of the Treasury Department on certain of the revenue initiatives included in the Presidents' fiscal year 1986 budget proposal. I will discuss whether the temporary increase in the cigarette excise tax should be extended, whether the deposit schedule for social security payroll taxes of state and local governments should be conformed to the private sector deposit schedule, and whether the industry pensions paid in addition to social security benefits under railroad retirement pensions should be taxed in the same manner as all other private industry pensions. Other Administrative officials will discuss other revenue initiatives proposed in the President's budget.

The Administration generally is opposed to any form of Federal tax increase at this time. Fees imposed for the use of Federal Government property or services, however, are an appropriate means of compensating the Federal Government for the expenses incurred in making such property or services available to the public, and thus other Administration witnesses will be testifying this morning in support of certain user fees.

DISCUSSION

Extension of the Cigarette Excise Tax

The current tax rate of 16 cents per pack of 20 cigarettes is scheduled to be reduced to 8 cents per pack on October 1, 1985. Our position is that the excise tax should be allowed to decline to 8 cents per pack on October 1 in accordance with current law.

Excise taxes are imposed upon cigars, cigarettes, and cigarette papers and tubes manufactured in or imported into the United States. In general, the manufacturer or importer is liable for these taxes when the products are removed from the factory or released from customs custody. The rate of tax imposed on small cigarettes (weighing no more than 3 pounds per thousand) removed from bonded premises before January 1, 1983 and after September 30, 1985 is $4 per thousand, which is equivalent to a tax of 8 cents per pack of 20 cigarettes. The rate of tax imposed on large cigarettes (weighing more than 3 pounds per thousand) is $8.40, which is equivalent to a tax rate of 16.8 cents per pack of 20 cigarettes. The Tax Equity and Fiscal Responsibility Tax Act of 1982 temporarily increased the rate of tax on small cigarettes to $8 per thousand, which is equal to a tax rate of 16 cents per pack. Similarly, the rate of tax imposed on large cigarettes was temporarily increased to $16.80 per thousand, which is equal to a tax rate of 33.6 cents per pack. These temporary increases are scheduled to expire on September 30, 1985.

Excise taxes on tobacco products discriminate against consumers who prefer to spend a portion of their incomes on these products. Moreover, the excise taxes on tobacco are regressive because low income individuals spend a larger percentage of their income on these products than wealthier individuals. According to the 1980-81 Consumer Expenditure Survey Diary Data, tobacco expenditures are 2.4 percent of income for the quintile of the population with the lowest income, but are only .4 percent of the income for the quintile of the population with the highest income.

In addition, state and local governments currently impose excise taxes on cigarettes. In 1984, state and local revenue from these taxes equaled $4.3 billion. To the extent that higher Federal taxes on tobacco products reduce tobacco consumption, they could restrict the ability of such governments to raise revenue from these sources. The cigarette excise tax is a relatively easy tax to administer, and, therefore, we regard it as appropriate that most of the revenue from the excise taxation of cigarettes is collected by the states.

In summary, the Treasury Department favors the scheduled termination of the temporary increase in the excise taxes on tobacco products on September 30, 1985.

State and Local Deposit of Social Security Payroll Taxes

Under present law, states that provide social security coverage for their employees and the employees of their political subdivisions are required to pay social security contributions attributable to such coverage directly to the Social Security Trust Fund within approximately two weeks following the semi-monthly period in which the covered wages were paid. If the state contributions are not paid timely, interest accrues at a rate of 6 percent per annum. The Secretary of Health and Human Services is responsible for ensuring that contributions are properly paid. States aggregate and deposit social security contributions on their own behalf, and on behalf of other governmental entities.

The Administration has submitted legislation to implement the revenue initiative in the President's budget that would treat the social security contributions of public employers as Federal Insurance Contributions Act (FICA) taxes -- as is the case for social security contributions of private employers and the Federal Government -- and thereby transfer the administration and collection of these contributions from the Department of Health and Human Services to the Internal Revenue Service. Under the proposed legislation, the states, their political subdivisions, and interstate instrumentalities would individually remit their social security contributions in the form of FICA taxes to the Internal Revenue Service along with the Federal income taxes they currently withhold, and states would no longer be liable for deposits of sub-state entities. The deposit schedule would be conformed to the private sector rules over a two-year phase-in period. The states and their political subdivisions would be subject to the same interest charges and penalties on late payments and would have the same rights to administrative appeal and judicial review under the Internal Revenue Code as private sector employers.

The Treasury Department favors treating social security contributions of public employers as FICA taxes. Conforming the state and local government deposit schedule to the deposit schedule of the private sector and placing the responsibility for the collection of all social security contributions with the Internal Revenue Service will lead to earlier and more efficient collection of these contributions.

Taxation of Railroad Retirement Benefits

Under present law, certain Railroad Retirement system benefits computed by using the social security benefit formula ("tier 1 benefits") are subject to Federal income tax in the same manner as social security benefits. Tier 1 benefits, however, may be available at an earlier age or in amounts in excess of benefits payable under the social security system.

Under the President's budget proposal, tier 1 benefits that equal the social security benefits to which the individual would have been entitled if all of the individual's employment on which the annuity is based had been employment for social security benefit purposes would continue to be taxed in the same manner as social security benefits. Other tier 1 benefits would be taxed under the rules that apply to all other payments under the Railroad Retirement system, i.e., they would be subject to Federal income tax to the extent payments received exceed the amount of the individual's previously taxed contributions to the plan. Thus, tier 1 benefits that are in excess of the social security benefits to which an individual would be entitled, or are payable at an age earlier than social security benefits, would be subject to tax in the same manner as all other payments under the Railroad Retirement system.

The Treasury Department supports this proposal. Beneficiaries of the Railroad Retirement system should receive the favorable tax treatment afforded social security benefits to the extent their tier 1 benefits are equivalent to what the individual would have received if the individual's employment under the Railroad Retirement system had been covered employment for social security purposes. Conversely, the portion of tier 1 benefits that is not equivalent to a social security benefit and, therefore, is essentially the same as a private pension benefit, should not be eligible for the special tax treatment accorded social security benefits, but should be taxed like all other private pensions.

* * *

This concludes my prepared remarks. I would be happy to respond to your questions.

'REASURY NEWS
artment of the Treasury • Washington, D.C. • Telephone 566-2041

For Release Upon Delivery
Expected at 8:00 p.m. EDT

Remarks by Secretary of Treasury
James A. Baker, III
before the New Hampshire Association
of Commerce and Industry
September 10, 1985

I am pleased to be here tonight. I'd like to talk about trade, from a strategic perspective, and then, tax reform. Business people recognize the importance of the strategic vision. One can't manage a business well by looking only to the next quarter's results. The same is true for government.

And it is particularly appropriate to discuss trade strategy in New Hampshire. Forty one years ago an historic meeting took place not far north of here. Representatives from 44 nations met at Bretton Woods to devise a postwar monetary system.

The Bretton Woods agreement was a cornerstone of a magnificent structure -- an open world economic system. Another cornerstone was the General Agreement on Tariffs and Trade, established in 1948 to roll back trade barriers.

Roots of the Postwar Free Trade System

The postwar system was built on the belief that the dark years of war and deprivation had roots in the economic turmoil of the depression. Nations had turned inward, restricting imports, clutching their own economic resources. The loss of economic freedom helped lead to the loss of political freedom. Trade wars were followed by real wars.

Perhaps the greatest self-defeating measure came in 1930. The United States passed the Smoot-Hawley tariff, the highest in our history. Emotions reached a fever pitch. One Member of Congress was loudly cheered by his colleagues when he suggested that the tariff wall be built so high that foreigners would break their legs trying to climb over it.

Our trading partners retaliated, one after another. The London Morning Post called on "all men of British blood, wherever they may sbe, to unite against this peril as they united against the Germans in 1914."

Post War Trading System And Prosperity

The postwar free trade system is designed to avoid the calamities of the 1930's.

Although the system failed to anticipate some new problems, it still worked fairly well. Trade and growth flourished. With the help of U.S. capital and markets, Japan and West Germany rebounded from the war to become leaders in the world economy. The less developed countries, also boosted by American trade and investment, grew rapidly.

In the quarter century after GATT began in 1948, world trade grew 7 percent annually. At the same time, the world economy grew a remarkable 5 percent a year.

In the past several years, a fast-growing U.S. economy boosted the incomes of our trading partners dramatically. Literally half the growth of European countries in 1983 and 1984 stemmed from our expansion's demand for their exports.

Our imports from the less developed countries helped keep their severe economic problems from spinning out of control with possible adverse consequences for our banking system.

The remarkable world growth over the last four decades could not have happened without the institutions of GATT and Bretton Woods.

The Bretton Woods monetary system provided for currency stability and economic growth for many years, before giving way to the current system of floating rates.

The GATT is the "conscience" of world trade. The Agreement itself is an extensive set of rules on what governments can and cannot do to affect trade. Its 90 member countries account for more than four fifths of all trade.

Numerous multilateral GATT negotiations dramatically cut trade barriers. Tariffs were reduced almost to insignificance.

System Now Under Stress

But now the free trade system is under enormous stress. A slower-growing, increasingly complex world economy is plagued by trade distortions often so sophisticated they are not covered by GATT.

The New York Times reports that Congress is under the "postwar era's greatest deluge of protectionism." Literally hundreds of protectionist bills have been proposed. Even the high tariff, the

scourge of the Depression, is threatening a comeback.

Some who call for barriers are motivated by the belief that the free trade system no longer works, that unfair traders are benefitting to our disadvantage. Others demand protection, pure and simple.

Our Trade Strategy

Our task is to revitalize the institution of free trade.

The system must be repaired, extended, and modernized. Its burdens and responsibilities should be better shared among nations. The United States must have access to resources and opportunities abroad just as other countries have benefitted from our open market in the postwar era.

This trade strategy has two parts, a "macroeconomic" part and a "trading system" part. In each, we try to take a long-term approach, avoiding counterproductive "quick-fixes."

The first part is to achieve sustained, noninflationary growth at home and abroad. To compete, our industries depend on sound economic policy here. Our exporters and investors need healthy markets abroad.

The second part is to promote a free and fair trade system at home and throughout the world, through negotiations and vigorous enforcement of our unfair trade laws.

Macroeconomic Policy

Let's look at the macroeconomic aspect in some detail. The broad economic factors behind our trade performance are all too often ignored at our peril. Unresolved economic problems almost invariably become trade problems.

Competitiveness begins at home. Government, business and labor must emphasize long-term economic growth over quick-fix solutions like protectionism and subsidies.

We've made great strides in reducing the burden of government on the economy in the last several years. The tax cuts in 1981, deregulation, and low inflation bolstered the economy and made business more efficient.

We've encouraged exports. The Export Trading Company Act of 1982 eased outmoded antitrust laws. We must continue to push to modernize those laws so that our companies can compete with large companies overseas.

And we should cut the budget deficit further in order to have a sound fiscal and monetary policy. Tax reform, which I'll say a few words about later, will allow Americans to channel their energy into productive enterprises rather than tax shelters.

Ultimately, responsibility for a competitive America rests with the private sector. Some pessimists say America no longer can compete, and needs protection. Just like a few years ago, when America was supposedly doomed to perpetual inflation and stagnation.

Then the economy sprang into the best recovery and expansion in many years. Management streamlined itself. Labor showed a wage and work-rule flexibility unheard of in many other industrialized countries. Management and labor didn't write America off. If we put our minds to it, we can compete. America is still the largest, most diverse and most dynamic economic engine in the world.

Convergence of Growth

The macroeconomic part of our trade strategy also involves working with other countries so that they may achieve durable growth. Ironically, our trade deficit has roots in our own economic strength.

America grew much faster than most others in recent years. This growth has drawn in imports while foreign demand for our products has lagged. The dynamic U.S. economy has also attracted record amounts of foreign investment. This drove up the price of the dollar, and consequently, the trade deficit.

At the Bonn Summit this year, we joined other nations in a cooperative effort to bring about convergent growth. The summit partners committed themselves to reducing the burden of government and achieving sustained, noninflationary growth.

We have seen some progress toward this goal of more balanced world growth. As United States growth slows to a more sustainable pace this year, other economies are converging with ours. Prospects for the LDC's are brighter.

As other countries become more attractive to foreign investors, downward pressure on the dollar will intensify. In fact, the dollar has declined considerably from its peak in February this year. About a third of its rise since the end of 1980 against the Japanese yen, the German mark, and the English pound has been reversed.

This decline has been moderate, and not precipitous. I do not expect a rapid fall in the dollar, contrary to some views I've heard. We don't have a target in mind -- I don't think anyone knows what the "correct" exchange rate for the dollar is. But I wouldn't be surprised, nor displeased, to see further moderate declines in the dollar as our policy of promoting the convergence of economic growth continues.

It will take time for exports to pick up. The potential is there, if other economies improve. For example, our exports to Mexico went up 32 percent last year, or $3 billion, because she made dramatic progress in servicing her foreign debt.

Strengthening Our Trading System

The second part of our trade strategy is to strengthen, extend and modernize the trading system. A free and fair system allows market forces to bring about the highest level of prosperity.

It's not abstract, ivory tower theory. We are talking about the living standards of all Americans. Only open markets can bring the most trade benefits, give Americans the broadest selection of goods at the best prices, and provide the most jobs and income.

We must oppose policies that distort world markets -- whether for products, services, investment, or currencies. Governments cannot achieve "protectionist prosperity" by using barriers to manage trade. Market forces always win out -- whether in the 1930's or the 1980's. If we work with market forces, we win too.

If we go against market forces, we lose. Others will not stand by passively if we engage in protectionist combat. Even in the short run, we may come out on the short end. Over time, all will suffer intensely. As President Reagan said recently, "there are no winners in a trade war -- only losers."

And the losses can be big everywhere -- inflation, production inefficiency, and retaliation. Protectionism destroyed jobs and income with frightening swiftness in the Depression.

Our exports are extremely vulnerable to retaliation. Forty percent of our farm produce is exported, one in every eight manufacturing jobs depends on exports. Consumers on tight budgets rely on low-cost imports. Manufacturers with paper-thin profit margins depend on imports for production.

Our responsibility to the world trading system is to keep our own markets as open as possible. Should the world's largest economy turn protectionist, the system would be endangered. To encourage protectionism at home is to encourage it abroad.

We've been generally successful in fulfilling this obligation to open markets. We allowed automobile import quotas to expire earlier this year. We strongly oppose the proposed 25 percent import surcharge and similar protectionism.

Shoe Import Decision

The issue of trade hit close to home for New Hampshire recently, with the decision not to impose quotas on shoe imports. We believe those restrictions would harm the nation, while giving no lasting help to the shoe industry.

The shoe quota would cost the American consumer almost $3 billion -- and hit low income consumers the hardest. Exporters might soon join them as victims.

U.S. footwear manufacturers already received protection from foreign imports between 1977 and 1981. They came out of those years

even more vulnerable to international competition than before.

Indeed, without the quotas, the shoe industry has shown some good signs of adjustment. Manufacturers have purchased state-of-the art manufacturing equipment, updated their operations, and diversified into profitable retail operations.

But no industry can do well in a weak economy. And that would be the result if we encouraged the spread of protectionism.

Instead of spending billions of consumer dollars to create temporary jobs, President Reagan has directed the Secretary of Labor to develop a plan to retrain unemployed workers in the shoe industry for real and lasting employment in other areas of the economy.

While we keep our markets open, our trading partners must do the same. We will take every step necessary to ensure that the system is free and fair. The system needs repairs and extension. And we need more stringent discipline for nations that violate the rules.

Our strategy requires bilateral and multilateral negotiations, as well as the vigorous enforcement of United States unfair trade laws.

GATT Negotiations

The best way to promote free and fair trade is through multilateral negotiations. We are encouraging GATT members to hold a round as soon as possible. It's been six years since the last GATT round in Tokyo. Much needs to be done.

Such negotiations are a far better approach than individual countries taking uncoordinated actions by themselves. The negotiations permit us to counterbalance powerful groups that benefit from protection with other groups that would benefit from free trade.

The negotiations should be broad in scope and coverage -- since trade restrictions are rapidly becoming more sophisticated and entrenched. All barriers to flows of goods, services, investment and ideas should be on the table. Both industrial and developing countries should participate in talks on these issues.

The system must more effectively cover agriculture, services and high technology, among other subjects. Such areas are of particular importance to the United States, and are vulnerable to subtle nontariff barriers.

In addition, GATT's system of dispute settlement has to be streamlined. Disputes can last for many years, and end without a clearcut decision. This undermines confidence in GATT.

Other Actions

We are confident that these shortcomings of GATT can be fixed. It is a fundamentally sound institution.

We will not, however, wait patiently for another GATT round if other nations dawdle.

If some countries hold back, we'll move forward with those who want to cooperate in order to share the advantages of free trade. We will negotiate multilaterally. We will negotiate bilaterally. We will seize every opportunity to tear down and hold down foreign trade barriers.

This summer, our actions with the European Community to increase citrus exports demonstrated our seriousness about foreign unfair trade practices.

Our most publicized bilateral relationship, of course, is with Japan. In the postwar years, Japan has gained tremendously from exporting. We greatly admire her economic success, and we can learn from some of her business skills.

Now Japan must allow her partners to export more to her. Our trade deficit with Japan, which may reach $50 billion this year, is not sustainable. We urge Japan not to limit her exports, but to increase her imports. Not just from the United States, but from others as well.

We are currently discussing with the Japanese four major sectors of their economy that should be more open to our exports. Progress in these talks has been slow. Some sectors are moving -- others are not. We will not rest until all four sectors are open.

Japan also must open up its economy to American investors, as ours is open for Japanese investors. Current Japanese law prohibits a foreign investment if it's likely to be competitive with domestic firms. As of now, we're the largest direct investor in the world -- with $233 billion throughout the world. But only $8 billion of that is in Japan.

Enforcing Unfair Trade Laws

As we pursue negotiations, we must also vigorously enforce our unfair trade laws. Our laws provide relief for those American businesses victimized by dumped or subsidized imports. In this area, the Administration initiated 122 investigations in fiscal year 1984, and 97 through June of this fiscal year. These laws are consistent with the GATT, and our rulings have been impartial.

We will intensify our attacks against unfair trade. Last week, President Reagan took an unprecedented step; he began three investigations of unfair trade practices under Section 301 of the Trade Act of 1974. The burden of filing a complaint used to be on private companies. Now they have the U.S. Government behind them. We will use our authority to take countermeasures if nations don't play by the rules.

The President also accelerated negotiations with Japan and the

European Community over certain of their unfair trade practices. He set a deadline for solving those problems -- December 1 of this year. If not solved by then, we will take countermeasures. We are putting other nations on notice that Section 301 will be used to its full power against those who refuse to treat American business fairly.

Summary Of Trade Strategy

President Reagan will speak out soon on his free trade policy. He will reaffirm its driving principles, and set forth some forceful new ideas about how to put these precepts into action. Some tactics may require the passage of new legislation.

The fundamentals of our trade strategy remain the same. Our aim is to achieve prosperity through economic freedom and fairness. Short-term "solutions" that ignore longterm market forces could be disastrous.

Protectionism, in particular, is a siren call that would leave our economy on the rocks. And surely other economies would follow. Like Ulysses, we must resist that seductive music and sail forward. The United States should be the navigator of efforts to repair and extend the free trade system.

And the burdens of that leadership should be shared more equally with other nations that thrive on free commerce. And we should not shrink from laying down the law with nations that weaken the system by ignoring the rules.

Tax Reform

I'd like to finish with a few words on an issue that also has much to do with our economy -- tax reform.

Our historic challenge is to build a fresh tax system that is fair, simpler, and economically efficient. We have a fair shot at passing real reform this year, and I'll tell you why.

The American people are deeply dissatisfied with the current code. It breeds scorn, envy and fear.

According to a recent poll, 4 out of 5 taxpayers believe the current system helps the rich and is unfair to the ordinary working man or woman. A majority believes the system is too complicated and that cheating is rampant.

This discontent with the tax system is deeply rooted. It draws on a populist spirit, a powerful American force that has cherished fairness and opposed special privilege throughout our history.

We must restore to the American people that which is rightfully theirs -- a tax system worthy of their respect. Otherwise, as respect for the current system erodes, respect for government in general weakens. To the extent that we can improve the tax system, we improve

government and the public's perception of government. To the extent we fail, we allow a corrosive virus of alienation and cynicism to persist.

So we must make fair a tax code that is marbled with inequities. We must simplify a code that defies the comprehension of all but those who spend their careers studying it. We must make efficient a tax code that capriciously distributes our national resources with little more logic than a roulette wheel. We must lower the exorbitantly high rates that send money fleeing into absurdly unproductive tax shelters.

Inaction or hesitation are no alternatives. If postponed, true reform may never happen. If attempted only piecemeal, comprehensive reform will once again degenerate into a parody of its lofty intent.

If we delay, a flawed tax system will catch up with us. And the price will be less growth, less opportunity, and less confidence in America.

Perhaps you've heard it said that destiny is not a matter of chance, it is a matter of choice. It is not a thing to be waited for, it is a thing to be achieved.

The way I see it, we can take a chance and wait. Or we can make a choice and achieve. It's clearly up to us. I think our decision should be evident.

Thank you.

TREASURY NEWS

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FOR IMMEDIATE RELEASE
SEPTEMBER 11, 1985

CONTACT: Art Siddon
(202) 566-5252

ORGANIZATION OF TREASURY DEPARTMENT

The Treasury Department today released a revised table of organization.

The new organization table reflects the establishment of an Under Secretary of Finance in order to strengthen the domestic financial policy and operations roles of the Department. It also reflects these changes:

The Assistant Secretary for Administration and Assistant Secretary for Electronic Systems are merged into Assistant Secretary for Management.

The Assistant Secretary for Business and Consumer Affairs and the Assistant Secretary for Policy, Planning and Communications are combined into Assistant Secretary for Public Affairs and Public Liaison.

The Office of Monetary Policy Analysis is reassigned to the Assistant Secretary for Economic Policy.

The Assistant Secretary for International Affairs now reports directly to the Deputy Secretary and the Secretary.

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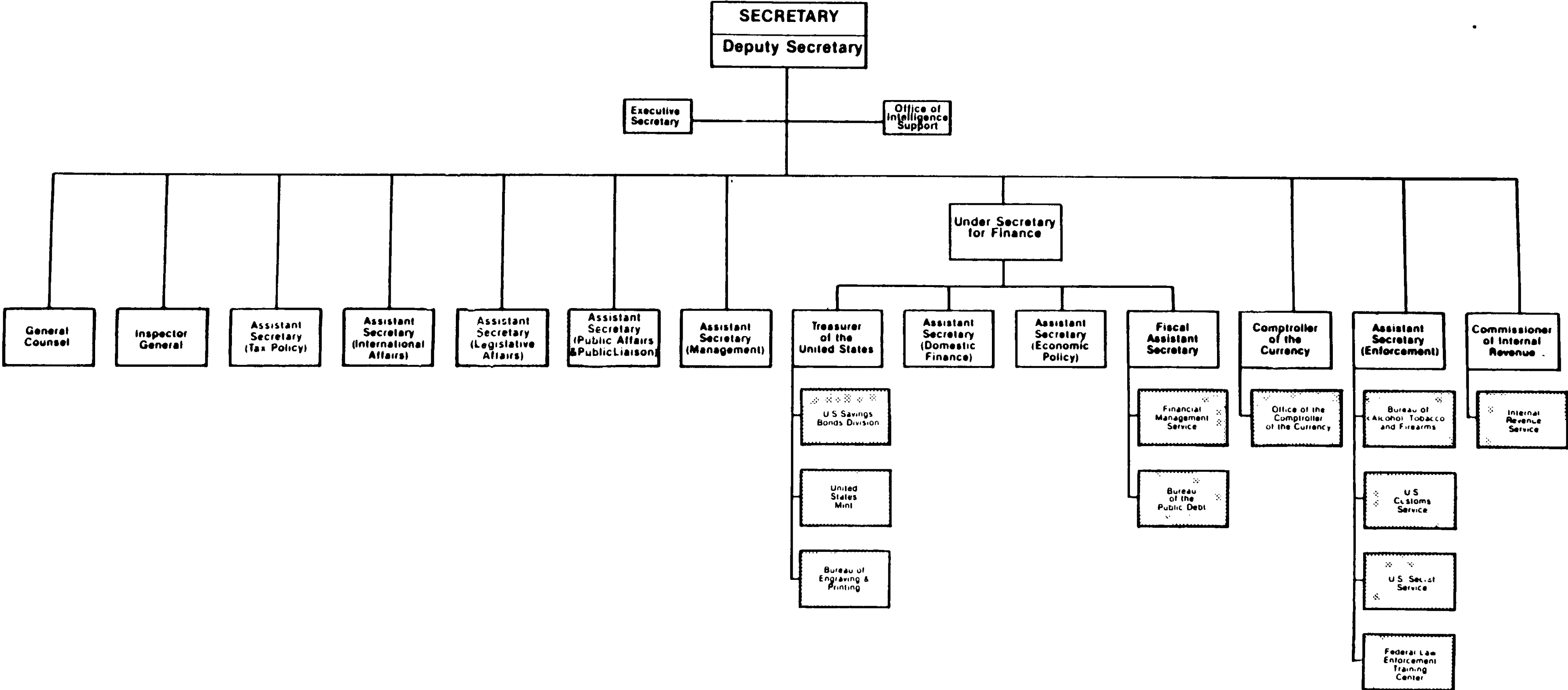
B-271

THE DEPARTMENT OF THE TREASURY



As of 8-26-85

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. September 11, 1985

TREASURY TO AUCTION $9,250 MILLION OF 2-YEAR NOTES

The Department of the Treasury will auction $9,250 million of 2-year notes to be issued September 30, 1985. This issue will provide about $875 million new cash, as the maturing 2-year notes held by the public amount to $8,372 million, including $671 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

In addition to the maturing 2-year notes, there are $3,357 million of maturing 4-year notes held by the public. The disposition of this latter amount will be announced next week. Federal Reserve Banks as agents for foreign and international monetary authorities currently hold $1,294 million, and Government accounts and Federal Reserve Banks for their own accounts hold $1,090 million of maturing 2-year and 4-year notes.

The $9,250 million is being offered to the public, and any amounts tendered by Federal Reserve Banks for their own accounts will be added to that amount. Tenders for such accounts will be accepted at the average price of accepted competitive tenders.

Due to the public debt limit and Treasury's need to plan for the debt level on September 30, additional amounts of the notes will not be issued to Federal Reserve Banks as agents for foreign and international monetary authorities in this auction.

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

HIGHLIGHTS OF TREASURY
OFFERING TO THE PUBLIC
OF 2-YEAR NOTES
TO BE ISSUED SEPTEMBER 30, 1985

September 11, 1985

Amount Offered:

To the public .... $9,250 million

Description of Security:

Term and type of security .... 2-year notes

Series and CUSIP designation .... Z-1987 (CUSIP No. 912827 SS 2)

Maturity Date .... September 30, 1987

Call date .... No provision

Interest 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 .... March 31 and September 30

Minimum denomination available .. $5,000

Terms of Sale:

Method of sale .... Yield auction

Competitive tenders .... Must be expressed as an annual yield, with two decimals, e.g., 7.10%

Noncompetitive tenders .... Accepted in full at the average price up to $1,000,000

Accrued interest payable by investor .... None

Payment by non-institutional investors .... Full payment to be submitted with tender

Payment through Treasury Tax and Loan (TT&L) Note Accounts ... Acceptable for TT&L Note Option Depositaries

Deposit guarantee by designated institution .... Acceptable

Key Dates:

Receipt of tenders .... Wednesday, September 18, 1985, prior to 1:00 p.m., EDST

Settlement (final payment due from institutions)

a) cash or Federal funds ...... Monday, September 30, 1985

b) readily-collectible check .. Thursday, September 26, 1985

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FOR IMMEDIATE RELEASE

Remarks by Secretary of the Treasury
James A. Baker, III
at the
Inter-American Investment Corporation
Signing Ceremony
September 12, 1985

President Ortiz Mena, Members of Congress, Members of the Diplomatic Corps, distinguished guests.

It is a pleasure to welcome you to the Treasury Department today for the signing of the Agreement establishing the Inter-American Investment Corporation.

At a time when we are used to reading about crises, we tend to forget that important policy developments often occur incrementally, without fanfare or publicity. Only a few of us may be aware that new institutions are being created -- institutions symbolic of major changes that have far reaching impacts.

The Inter-American Investment Corporation fits that definition. Newspaper headlines focus on the negative dimensions of the debt crisis in Latin America. They overlook important changes that are occurring in Latin America and the Caribbean. Governments in those countries are working hard to strengthen their economies by increasing the role of the private sector and by reducing government intervention in the market place.

The IIC will work to speed the pace of that process. It is a multilateral organization affiliated with the Inter-American Development Bank and aimed at strengthening the private sector in Latin America and the Caribbean. Its capital -- $200 million -- is small in comparison to the numbers that make the headlines. It may be new and small, but its role will be catalytic, because it will mobilize both domestic and foreign investment flows to the region.

Its main focus will be on strengthening small- and medium-sized enterprises in Latin America and the Carribean -- exactly those enterprises whose success will be critical to dynamic growth in these countries.

We may not hear much about the IIC as it goes about its business of making loans and taking equity positions in small- and medium-sized enterprises. Yet enterprises in which it invests will be providing jobs, earning or saving foreign exchange, bringing new technology and managerial skills to promote growth, and producing goods that enable other enterprises to operate more efficiently. But perhaps most importantly, they will be providing outlets for the entrepreneurial spirit so essential in a healthy privte sector.

The IIC will be an international institution grounded in goodwill and diplomacy. It will also be a business enterprise designed to operate efficiently with a clear sense of mission. It is an example of how much we can accomplish if we work together to solve common problems. Members of the Inter-American Development Bank recognized a problem that was retarding growth in Latin America -- the unfulfilled potential and opportunities of free enterprise. Recognizing the challenge of individual freedom and initiative in economic development, they proceeded to deal with the problem in a creative and cooperative way by focusing on the unrealized potential of small- and medium-sized enterprises. The IIC is the outcome.

And those who worked hard for its establishment deserve our congratulations. In addition to the legislative support the institutions received, the leadership and vision of President Ortiz Mena and Treasury Deputy Assistant Secretary Jim Conrow did much to shape the IIC. But the person behind U.S. participation in the IIC, and the person who set the basic political groundwork, is Jose Manuel Casanova, our Executive Director in the Inter-American Development Bank. I ask Manolo to stand for the recognition he so richly deserves.

We are here today to implement President Reagan's decision that the United States should join the Inter-American Investment Corporation. I am pleased to add the United States to the present list of signatories. And I urge others to move toward becoming IIC members. The IIC has an important role to play in the development of Latin American and the Caribbean economies. We look forward to continuing close cooperation with our colleagues in Latin America to address the problems of the present and the future.

I want to thank <u>all</u> of our guests for being here today. Your presence confirms our faith in this promising enterprise.

Thank you very much. I now ask Don Antonio Ortiz Mena to join me in signing the IIC agreement and related documents.

TREASURY NEWS

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STATEMENT OF EDWARD T. STEVENSON
ACTING ASSISTANT SECRETARY (ENFORCEMENT AND OPERATIONS)
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
SEPTEMBER 12, 1985

The Role of the Department of the Treasury in the Fight Against Money Laundering

Mr. Chairman and Members of the Committee:

Thank you sincerely for the opportunity to appear before you today to discuss the problem of money laundering. The Treasury Department welcomes your interest in this topic, which is of vital importance to law enforcement, to the financial community, and to our society at large. In my testimony today, I will discuss the scope of the money laundering problem and some of the reasons why it is so pervasive. I will explain why Treasury believes that an attack on money laundering is essential to a successful fight against organized crime and drug trafficking. I will then summarize the progress we have made, under both the civil and the criminal enforcement powers at our disposal. Finally, I will address very briefly the pending legislation that has the potential to further our progress. Jim Knapp, Deputy Assistant Attorney General for the Criminal Division, will discuss this legislation in further detail in his testimony today.

What Money Laundering is and Why it Poses a Difficult Challenge to Law Enforcement

At the outset, I would like to define what we mean by the term "money laundering". I am referring to any scheme by which criminals or their cohorts strive to conceal the illegal source of their income and to make their proceeds appear legitimate.

Mr. Chairman, for a number of reasons, money laundering is a major challenge for law enforcement. First, the scope of the problem is staggering. While no one knows with certainty how much money is laundered in the United States every year, estimates point to anywhere between $50 and $75 billion in laundered crime proceeds from drug trafficking alone. From

money laundering cases Treasury has investigated, we know that a single money laundering enterprise can wash $300 million or more in crime proceeds in less than a year's time.

Suppressing money laundering is enormously difficult for another reason: there are seemingly infinite ways for criminals to accomplish it. Treasury investigators have uncovered money laundering schemes that are as varied as the human imagination will allow. They can be conducted domestically or internationally, and they can exploit various types of financial institutions. Because virtually all organized crime depends on skilled money launderers for its very existence, there is a continuous incentive for criminals to develop new methods for circumventing Federal reporting requirements and for concealing cash and pools of assets from the eyes of law enforcement.

Money laundering has seen unprecedented growth over the last decade for another basic reason: it is an extremely lucrative criminal enterprise. Treasury's investigations have uncovered members of an emerging criminal class: They are the professional money launderers who aid and abet other criminals through financial activities. Some may not consider themselves to be criminals. These individuals do not fit the stereotype of an underworld criminal. They are accountants, attorneys, money brokers, and members of other legitimate professions. They need not become involved with the underlying criminal activity except to conceal and transfer the proceeds that result from it. They are drawn to their illicit activity for the same reason that drug trafficking attracts new criminals to replace those who are convicted and imprisoned; and that reason is greed. Money laundering appears to them as an easy route to almost limitless wealth.

An Attack on Money Laundering is Essential to the Fight Against Organized Crime and Drug Trafficking

Mr. Chairman, the difficulties I have mentioned should not cause anyone to believe that our fight against money laundering is a hopeless one. Quite to the contrary: in the past four years, we have recorded substantial progress. I will give some examples of this progress in a moment. But for now, let me stress a principle that our financial investigations have demonstrated time and time again: that we can never hope to control drug trafficking and other forms of organized crime in our society unless we continue our efforts to go after the money that is at the heart of every criminal enterprise. The reasons behind this conclusion are fundamental ones.

Money, of course, is the motivation behind every organized crime transaction and the thread that ties together the components of a criminal enterprise. If we can trace the money, the trail will often lead to high-level criminals. The leaders in any

criminal enterprise usually take great pains to distance themselves from the illegal source of their income. But they can usually be found close to the money.

The money, if seized, is potentially devastating evidence at a criminal trial. A jury can get lost in the technical details of a white collar crime. But if jurors can be shown the illicit proceeds, they can more readily understand the full impact of the crime.

Also, through seizure and forfeiture, we can deprive a criminal enterprise of its lifeblood. For instance, drugs can be readily replaced by a drug trafficking organization, but its cash reserves are essential to its functioning. It is this cash that finances new drug importing ventures, and is the means of corrupting justice. Large monetary seizures can cripple the organization and possibly put it out of business altogether.

Treasury's investigative successes under the Bank Secrecy Act, which have been achieved by IRS and Customs Special Agents, demonstrate the validity of this approach. In 1980, Treasury, with the support of the Justice Department, organized Operation Greenback in Miami to conduct financial investigations using the reporting information provided by the Bank Secrecy Act. The Treasury task forces modeled after Greenback now total approximately forty in number, located in cities across the nation.

Since 1980:

- They have produced over 1300 indictments and over 460 convictions;
- They have resulted in $81.8 million in currency seizures and $34.3 million in property seizures; and
- They have destroyed nineteen major money laundering enterprises, which laundered a documented total of $2.8 billion.

Greenback itself has become a component in one of the President's Organized Crime Drug Enforcement Task Forces, which now number thirteen. These Task Forces have initiated over 1000 cases, even though they have been fully operational for only a little more than two years. They have produced indictments of more than 6300 individuals and have resulted in more than 2500 convictions. Two out of three Task Force cases have a financial component.

Treasury has contributed approximately 480 special agents to work full-time on the OCDE Task Forces, 400 of which are IRS and Customs agents who are investigating money laundering. The other 80 agents are ATF agents who are investigating the firearms violators who participate in and support the drug trade and organized crime.

Treasury's Enforcement of the Bank Secrecy Act

The Bank Secrecy Act is the cornerstone of Treasury's financial enforcement effort. The reporting and record-keeping information it authorizes Treasury to require is essential for the investigations conducted by the task forces that I have described.

Specifically, beginning in 1972, Treasury has issued and periodically revised its regulations that effectuate the Bank Secrecy Act. These regulations require banks to maintain certain basic records, including the following:

-- cancelled checks and debits over $100;
-- signature cards;
-- statements of account;
-- extensions of credit in excess of $5,000; and
-- records of international transfers of more than $10,000.

The regulations also provide for the following reports:

-- First, all financial institutions are required to report to IRS currency transactions in excess of $10,000. There are a few exceptions to this requirement. Transactions solely with or originated by financial institutions need not be reported. Also, financial institutions may exempt from reporting transactions with established customers maintaining deposit relationships, provided that the amounts deposited do not exceed amounts that are reasonable and customary given the type of business engaged in by the customer, and further provided that the business is of a type that customarily produces large cash receipts.

-- Second, with the exception of certain shipments made by banks, the international transportation of currency and certain other monetary instruments in bearer form and in excess of $10,000 is required to be reported to the Customs Service. The civil sanctions for vio-

lations of this requirement are especially powerful. Customs can seize the entire amount of unreported currency or other monetary instruments involved in a violation at the time a violation occurs. If a violation is detected too late to effect a seizure, Treasury can assess a civil penalty equal to the amount of unreported monetary instruments that were not seized.

-- Third, Treasury requires reporting of the ownership or control of foreign financial accounts, by all persons subject to U.S. jurisdiction.

In addition to the responsibility for implementing the purposes of the Act through regulations, the Secretary of the Treasury exercises overall responsibility for ensuring compliance with the recordkeeping and reporting requirements of the Act. In accordance with the intent of the Act, Treasury's implementing regulations delegate this responsibility to those agencies that supervise the various financial institutions.

Certainly, full compliance with the reporting requirements is essential. Treasury depends on the reporting data generated by these requirements for its own financial investigations and the analytical support it provides other law enforcement agencies.

The Treasury Financial Law Enforcement Center, or TFLEC, combines these data with other sources of intelligence to generate financial intelligence reports, currency flow charts, and link analyses, which probe the financial connections inside and among illicit enterprises. TFLEC provides vital support to ongoing investigations, including those of the OCDE and Treasury Task Forces, and it generates leads for the development of new cases.

It is fair to say that were it not for the reporting information Treasury receives as a result of the Bank Secrecy Act, the major money laundering enterprises I mentioned earlier would all be thriving today. To ensure the availability of reports, we must continue to improve the level of compliance by financial institutions.

As the Committee is aware, the Department of the Treasury is currently involved in an unprecedented number of civil penalty cases against financial institutions. This activity is an aftermath of the Bank of Boston case. In February, the First National Bank of Boston pleaded guilty to failure to file currency transactions reports in violation of the Bank Secrecy Act in 1,163 instances. The transactions involved bank-to-bank transfers of currency between the Bank of Boston and foreign banks.

As a result of the publicity following the Bank of Boston case, over sixty banks have come forward to disclose Bank Secrecy Act violations, many on a voluntary basis. On June 18, 1985, Treasury announced that civil penalties ranging from $210,000 to $360,000 had been imposed on four of these banks -- Chase Manhattan Bank, Manufacturers Hanover Trust, Irving Trust and Chemical Bank. On August 27, Treasury imposed a civil penalty of $2.25 million against Crocker National Bank based on over 7800 reporting violations. This is the largest Bank Secrecy Act civil penalty imposed by Treasury to date. Crocker's non-compliance problem was discovered in the course of a compliance audit by an alert national bank examiner from the Office of the Comptroller of the Currency.

All of the banks, including Crocker, cooperated fully with Treasury in developing the scope of their liability. Treasury is not aware of any related criminal conduct on the part of any of the banks against which civil penalties have been assessed. The cases of the other banks that have come forward are currently under review.

In addition, my office has authorized the Internal Revenue Service to conduct criminal Bank Secrecy Act investigations of financial institutions in approximately 400 cases. Of these, approximately 100 authorizations are still in effect.

We also have been working with the financial institution regulatory agencies to strengthen their Bank Secrecy Act audit procedures. More rigorous audits should lead to improved compliance.

We have strengthened the Treasury Bank Secrecy Act regulations in several respects: On May 7, 1985, regulations became effective that designated casinos as financial institutions subject to certain Bank Secrecy Act reporting and recordkeeping requirements. As evidenced by hearings by the President's Commission on Organized Crime this summer, money laundering through casinos may be even more widespread than once thought. The Treasury regulations should foreclose the attractiveness of the use of casinos for money laundering.

Finally, a regulatory amendment pertaining to international transactions was published as a final rule in the Federal Register on July 8, 1985. These regulations do not themselves impose any reporting requirements. Under the regulations, however, Treasury will be able in the future to select a financial institution or a group of financial institutions for defined periods of time, for reporting of specified international transactions, including wire transfers. We envision that this will require reporting of transactions with financial institutions in designated foreign locations that would produce especially useful information concerning money laundering or tax evasion.

This effort reflects Treasury's intention to make further progress against the problem of international money laundering. Another aspect of our attack on money laundering offshore is our negotiation with foreign governments that have stringent bank secrecy laws. Treasury has worked closely with the Departments of Justice and State to obtain the cooperation of these governments for the release of financial information relevant to possible violations of law. The agreement our government has reached with Great Britain that provides for access by U.S. prosecutors to information located in the Cayman Islands that is relevant to narcotics violations is a direct result of this endeavor.

The Administration's Money Laundering Bill

The Bank Secrecy Act, while an effective law enforcement tool, is not enough, standing alone, to combat money laundering. As long as currency transaction are properly reported, the Bank Secrecy Act contains no sanction for money laundering. What is clearly needed is legislation that makes money laundering itself a criminal offense and provides severe financial consequences for a financial institution that facilitates laundering. That is why the Departemnt of the Treasury is pround to have worked with the Department of Justice in developing the Administration bill to combat money laundering, the "Money Laundering and Related Crimes Act of 1985" (H.R. 2785 and 2786). We look forward to early, favorable Congressional action on this bill.

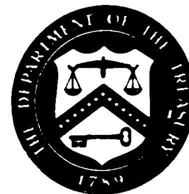
The bill makes it an offense to conduct a financial transaction with the intent to promote any unlawful activity or with knowing or reckless disregard that the funds represent the proceeds of an unlawful activity. Unlawful activity is defined broadly to include all federal and state felonies -- including tax offenses and failures to report under the Bank Secrecy Act. The bill confers joint investigative authority on the Department of Justice and the Department of the Treasury. We envision that Treasury investigations would be conducted, as are the Bank Secrecy Act investigations, by the Customs Service and the Internal Revenue Service, as appropriate. The bill provides both civil and criminal forfeiture authority of any funds or monetary instruments involved in a violation including where the underlying unlawful activity is an internal revenue offense.

The bill also contains several amendments to the Bank Secrecy Act that are essential to more effective enforcement by the Secretary of the Treasury. Most important, the Secretary would be given for the first time summons authority for both financial institution witnesses and documents in connection with Bank Secrecy Act cases. Also the bill would increase the current civil penalty for willful violation from $10,000 per transaction to the amount of the transaction up to $1,000,000 or $25,000, whichever is greater. The bill also provides for a penalty for mere negligent violations by financial institutions.

While the increased civil penalties would apply to financial institutions, Treasury interprets the term "financial institution" broadly. As the Second Circuit recently held, Congress did not intend "financial institution" to be defined solely as legitimate, ongoing business concerns, but to also include any enterprise or person engaging in the exchange of currency for profit. United States v. Goldberg, 756 F.2d 949 (1985), cert. denied, 53 L.W. 3865 (6/11/85)).

Mr. Chairman, this completes my formal testimony today. The Deputy Assistant Attorney General, Criminal Division, James I.K. Knapp, is here today and will discuss the Administration's bill in more detail.

TREASURY NEWS



Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
September 13, 1985

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ELECTION BY LIFE INSURANCE COMPANIES UNDER SECTION 818 (f) (2)

The Treasury Department today announced the method by which life insurance companies may elect to apportion or allocate certain items among items of gross income for purposes of the foreign tax credit and other purposes. The items which may be apportioned or allocated under this election are described in section 818(f)(1) of the Internal Revenue Code and include the deduction for policyholder dividends, death benefits, and reserve adjustments under section 807(a) and (b). The election, which is permitted under section 818(f)(2) of the Code, must be made by September 16, 1985.

The Treasury Department said that the election is made by attaching a statement to the life insurance company's income tax return (or amended return) for its first taxable year beginning after December 31, 1983, or by mailing a separate statement to the Internal Revenue Service Center with which the company's return is filed. In either case, the statement must be mailed by September 16, 1985. The statement should include the following:

- The name, address, and taxpayer identification number of the life insurance company;
- A statement that the company is making an election under section 818(f)(2); and
- If the statement is not attached to the company's 1984 tax return, a notation to the effect that the statement should be associated with that return.

The Treasury Department also said that, until temporary or final regulations prescribing apportionment and allocation rules under section 818(f)(2) are issued, life insurance companies making the election may apportion or allocate the items to gross income in the manner prescribed in either section 818(f)(1) or section 1.861-8 of the Income Tax Regulations. After the issuance of temporary or final regulations, any life insurance company that has made the election under section 818(f)(2) will be permitted a limited period within which to revoke the election. Companies that do not revoke the election will be required to amend their 1984 tax returns if an amendment is necessary to comply with the apportionment and allocation rules in those regulations.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE September 16, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $7,220 million of 13-week bills and for $7,202 million of 26-week bills, both to be issued on September 19, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing December 19, 1985			26-week bills maturing March 20, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	7.14%	7.37%	98.195	7.31%	7.70%	96.304
High	7.18%	7.41%	98.185	7.33%	7.72%	96.294
Average	7.17%	7.40%	98.188	7.32%	7.71%	96.299

Tenders at the high discount rate for the 13-week bills were allotted 8%.
Tenders at the high discount rate for the 26-week bills were allotted 38%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 67,295	$ 47,295	$ 68,500	$ 47,780
New York	17,271,610	5,466,070	16,775,980	6,252,360
Philadelphia	45,450	45,450	26,090	26,090
Cleveland	54,080	54,080	40,305	40,305
Richmond	91,815	51,465	104,445	51,345
Atlanta	50,470	43,030	56,555	50,245
Chicago	2,074,775	865,255	1,158,175	123,935
St. Louis	93,940	53,940	86,075	46,075
Minneapolis	316,865	132,865	44,325	19,325
Kansas City	60,070	58,950	46,535	46,375
Dallas	42,110	32,110	39,215	29,215
San Francisco	3,093,785	82,865	2,470,360	98,090
Treasury	286,275	286,275	371,115	371,115
TOTALS	$23,548,540	$7,219,650	$21,287,675	$7,202,255
Type				
Competitive	$20,079,125	$3,750,235	$17,750,745	$3,665,325
Noncompetitive	1,160,160	1,160,160	1,103,130	1,103,130
Subtotal, Public	$21,239,285	$4,910,395	$18,853,875	$4,768,455
Federal Reserve	1,899,055	1,899,055	1,900,000	1,900,000
Foreign Official Institutions	410,200	410,200	533,800	533,800
TOTALS	$23,548,540	$7,219,650	$21,287,675	$7,202,255

1/ Equivalent coupon-issue yield.

B-276

federal financing bank NEWS
WASHINGTON, D.C. 20220
Press 566-2041
FFB 566-2468

FOR IMMEDIATE RELEASE September 13, 1985

FEDERAL FINANCING BANK ACTIVITY

Francis X. Cavanaugh, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of July 1985.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $153.0 billion on July 31, 1985, posting an increase of $1.0 billion from the level on June 30, 1985. This net change was the result of increases in holdings of agency assets of $0.9 billion and holdings of agency-guaranteed debt of $0.3 billion. Holdings of agency debt declined by $0.3 billion during the month. FFB made 313 disbursements during July.

Attached to this release are tables presenting FFB July loan activity, new FFB commitments entered during July and FFB holdings as of July 31, 1985.

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B-277

FEDERAL FINANCING BANK

JULY 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
ON-BUDGET AGENCY DEBT					
TENNESSEE VALLEY AUTHORITY					
Advance #486	7/2	$ 470,000,000.00	7/10/85	7.205%	
Advance #487	7/8	480,000,000.00	7/16/85	7.105%	
Advance #488	7/10	465,000,000.00	7/18/85	7.305%	
Advance #489	7/16	254,000,000.00	7/22/85	7.385%	
Advance #490	7/16	200,000,000.00	7/25/85	7.385%	
Advance #491	7/17	462,000,000.00	7/25/85	7.335%	
Advance #492	7/22	237,000,000.00	7/29/85	7.515%	
Advance #493	7/25	161,000,000.00	8/1/85	7.605%	
Advance #494	7/29	249,000,000.00	8/5/85	7.545%	
Advance #495	7/31	173,000,000.00	8/8/85	7.645%	
Power Bond Series 1985 D	7/25	500,000,000.00	7/31/15	10.725%	
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
+Note #337	7/1	65,000,000.00	9/30/85	7.185%	
+Note #338	7/11	2,000,000.00	10/9/85	7.285%	
+Note #339	7/15	41,300,000.00	10/15/85	7.455%	
Note #340	7/16	1,500,000.00	10/10/85	7.385%	
+Note #341	7/22	550,000.00	10/21/85	7.545%	
+Note #342	7/29	7,225,000.00	10/28/85	7.555%	
Note #343	7/31	5,000,000.00	10/28/85	7.625%	
OFF-BUDGET AGENCY DEBT					
UNITED STATES RAILWAY ASSOCIATION					
*Note #33	7/1	75,257,025.29	9/30/85	7.185%	
AGENCY ASSETS					
FARMERS HOME ADMINISTRATION					
Certificates of Beneficial Ownership					
	7/1	450,000,000.00	7/1/95	10.375%	10.644% ann.
	7/1	40,000,000.00	7/1/05	10.735%	11.023% ann.
	7/5	75,000,000.00	7/1/95	10.355%	10.623% ann.
	7/15	100,000,000.00	7/1/95	10.355%	10.623% ann.
	7/15	60,000,000.00	7/1/00	10.585%	10.865% ann.
	7/15	25,000,000.00	7/1/05	10.725%	11.013% ann.
	7/29	140,000,000.00	7/1/95	10.705%	10.991% ann.
	7/29	30,000,000.00	7/1/00	10.955%	11.255% ann.
	7/29	35,000,000.00	7/1/05	11.095%	11.403% ann.
	7/31	95,000,000.00	7/1/95	10.785%	11.076% ann.
	7/31	190,000,000.00	7/1/00	10.995%	11.297% ann.
	7/31	30,000,000.00	7/1/05	11.115%	11.424% ann.
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Turkey 13	7/1	38,627,345.46	3/24/12	10.672%	
Turkey 16	7/1	2,956,199.00	7/15/13	10.669%	
El Salvador 7	7/2	42,500.00	6/10/96	10.343%	
Niger 2	7/2	41,324.98	10/15/90	7.675%	
Tunisia 16	7/2	1,389.00	2/5/96	10.345%	
Egypt 7	7/5	21,922,643.90	7/31/14	10.608%	
Zaire 3	7/9	126,364.00	9/15/94	10.135%	

+rollover
*maturity extension

FEDERAL FINANCING BANK

JULY 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
Foreign Military Sales (Cont'd)					
Botswana 4	7/10	$ 1,108.16	7/25/92	7.535%	
Egypt 7	7/10	1,407,709.59	7/31/14	10.505%	
Jordan 11	7/10	1,261,513.22	11/15/92	8.853%	
Greece 15	7/11	123,545.80	6/15/12	10.315%	
Peru 9	7/11	131,807.03	9/15/95	9.949%	
Morocco 13	7/12	19,735.00	5/31/96	9.945%	
Turkey 16	7/12	10,335,521.27	7/15/93	10.609%	
El Salvador 7	7/12	34,500.00	6/10/96	10.375%	
Egypt 7	7/15	21,514,276.35	7/31/14	10.660%	
Turkey 13	7/15	466,732.15	3/24/12	10.625%	
El Salvador 7	7/16	727,367.82	6/10/96	10.395%	
Turkey 17	7/16	27,845,212.69	11/30/13	10.379%	
Jordan 10	7/17	1,234,839.89	3/10/92	8.230%	
Thailand 11	7/17	378,659.56	9/10/95	10.235%	
Egypt 7	7/19	4,234,875.00	7/31/14	10.775%	
Tunisia 16	7/19	16,243.80	2/5/96	10.455%	
Egypt 7	7/22	1,153,843.56	7/31/14	10.795%	
Jordan 11	7/22	181,495.55	11/15/92	9.315%	
Spain 5	7/22	4,429,977.55	6/15/91	9.915%	
Morocco 13	7/24	793,981.56	5/31/96	10.225%	
Thailand 11	7/24	8,532,605.00	9/10/95	10.555%	
Jordan 10	7/25	31,280.87	3/10/92	8.815%	
Jordan 12	7/25	71,090.15	2/5/95	10.495%	
Portugal 1	7/25	4,323,137.00	9/10/94	10.095%	
Morocco 12	7/29	12,242.24	9/21/95	10.685%	
Morocco 13	7/29	587,461.73	5/31/96	10.285%	
Turkey 17	7/29	4,861,788.00	11/30/13	10.849%	
Zaire 3	7/29	23,802.00	9/15/94	10.685%	
Philippines 10	7/30	299,475.52	7/15/92	10.135%	
DEPARTMENT OF ENERGY					
Synthetic Fuels - Non-Nuclear Act					
+Great Plains Gasification Assoc. #137	7/1	398,900,000.00	8/1/85	7.995%	
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT					
Community Development					
*Albany, NY	7/1	640,000.00	7/1/90	9.747%	9.985% ann.
New Haven, CT	7/1	200,000.00	9/1/04	10.480%	10.755% ann.
*Baldwin Park, CA	7/1	142,500.00	7/1/91	9.555%	9.783% ann.
South Bend, IN	7/5	72,762.34	2/15/86	7.615%	7.668% ann.
Newport News, VA	7/5	12,000.00	2/15/86	7.615%	7.668% ann.
Lynn, MA	7/5	210,816.64	8/15/85	7.365%	
Jersey City, NJ	7/5	22,500,000.00	10/1/86	8.085%	8.248% ann.
Waukegan, IL	7/5	274,325.00	9/1/85	7.365%	
Santa Ana, CA	7/10	282,000.00	8/15/86	7.885%	8.040% ann.
Yonkers, NY	7/10	1,650,000.00	12/15/85	7.485%	
Pasadena, CA	7/15	2,931,753.83	9/15/91	9.580%	9.809% ann.
Dade County, FL	7/15	3,772,772.00	7/15/89	9.073%	9.279% ann.
Rochester, NY	7/16	100,000.00	8/31/04	10.512%	10.788% ann.
Santa Ana, CA	7/19	347,000.00	8/15/86	8.085%	8.248% ann.
St. Louis, MO	7/24	1,000,000.00	2/15/86	7.905%	7.939% ann.
Omaha, NE	7/26	500,000.00	5/31/17	8.995%	9.197% ann.
Ponce, PR	7/30	145,257.00	8/1/85	7.605%	
DEPARTMENT OF THE NAVY					
Ship Lease Financing					
+Williams	7/9	63,200,359.00	7/15/85	7.255%	

*maturity extension
+rollover

FEDERAL FINANCING BANK

JULY 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
Ship Lease Financing (Cont'd)					
+Buck	7/10	$ 23,290,000.00	7/15/85	7.305%	
+Hauge	7/15	127,806,502.52	10/15/85	7.455%	
+Kocak	7/15	106,462,912.85	10/15/85	7.455%	
+Baugh	7/15	124,202,449.12	10/15/85	7.455%	
+Obregon	7/15	107,879,688.62	10/15/85	7.455%	
+Bobo	7/15	118,839,782.17	10/15/85	7.455%	
+Anderson	7/15	120,680,368.76	10/15/85	7.455%	
+Pless	7/15	105,919,489.26	10/15/85	7.455%	
+Williams	7/15	116,422,407.03	10/15/85	7.455%	
+Bobo Container	7/15	2,200,359.00	10/15/85	7.455%	
+Pless Container	7/15	2,330,000.00	10/15/85	7.455%	
+Buck	7/15	68,290,000.00	10/15/85	7.455%	
+Williams	7/15	59,738,951.97	7/17/85	7.435%	
Williams Container	7/17	2,200,359.00	10/15/85	7.355%	
Defense Production Act					
Gila River Indian Community	7/12	337,767.54	10/1/92	9.764%	9.648% qtr.
RURAL ELECTRIFICATION ADMINISTRATION					
*Colorado Ute Electric #96	7/1	484,000.00	7/1/87	8.795%	8.700% qtr.
*North Carolina Electric #185	7/1	7,517,000.00	9/30/87	8.895%	8.798% qtr.
*Deseret G&T #211	7/1	8,274,000.00	1/2/18	10.622%	10.485% qtr.
*Southern Illinois Power #38	7/1	2,000,000.00	9/30/87	8.881%	8.785% qtr.
Tex-La Electric #208	7/1	735,939.19	12/31/19	10.620%	10.483% qtr.
Kepco #282	7/1	814,475.89	12/31/15	10.618%	10.481% qtr.
Saluda River Electric #186	7/1	2,562,242.79	12/31/19	10.620%	10.483% qtr.
*Wabash Valley Power #104	7/1	4,823,000.00	7/1/87	8.795%	8.700% qtr.
*Wabash Valley Power #206	7/1	10,571,000.00	7/1/87	8.795%	8.700% qtr.
*Tex-La Electric #208	7/1	3,213,000.00	1/2/18	10.622%	10.485% qtr.
*S. Mississippi Electric #171	7/1	9,948,000.00	12/31/15	10.623%	10.486% qtr.
*Kansas Electric #216	7/1	2,067,500.00	1/3/17	10.622%	10.485% qtr.
*Kansas Electric #216	7/1	4,572,000.00	12/31/17	10.622%	10.485% qtr.
Basin Electric #87	7/1	504,000.00	12/3/85	7.355%	7.300% qtr.
Basin Electric #232	7/1	1,107,000.00	12/3/85	7.355%	7.300% qtr.
Wolverine Power #182	7/1	3,457,000.00	6/30/88	9.205%	9.101% qtr.
Wolverine Power #183	7/1	4,389,000.00	6/30/88	9.205%	9.101% qtr.
Wolverine Power #191	7/1	700,000.00	6/29/88	9.205%	9.101% qtr.
Wolverine Power #234	7/1	16,002,000.00	7/1/87	8.795%	8.700% qtr.
Wolverine Power #274	7/1	20,785,000.00	9/30/87	8.885%	8.788% qtr.
Deseret G&T #211	7/1	22,443,000.00	7/1/87	8.795%	8.700% qtr.
North Carolina Electric #268	7/1	28,191,000.00	9/30/87	8.895%	8.798% qtr.
New Hampshire Electric #270	7/1	2,281,000.00	12/31/17	10.622%	10.485% qtr.
Kansas Electric #282	7/1	5,800,524.11	12/31/15	10.618%	10.481% qtr.
Tex-La Electric #208	7/1	3,519,060.81	12/31/19	10.620%	10.483% qtr.
Saluda River Electric #186	7/1	9,773,757.21	12/31/19	10.620%	10.483% qtr.
Western Farmers Electric #196	7/2	4,005,000.00	12/31/19	10.590%	10.453% qtr.
Cajun Electric #263	7/2	50,000,000.00	12/31/16	10.541%	10.406% qtr.
*S. Mississippi Electric #171	7/2	12,649,000.00	12/31/17	10.591%	10.454% qtr.
Western Farmers Electric #261	7/3	15,985,000.00	1/2/01	10.309%	10.179% qtr.
Central Electric #131	7/8	130,000.00	7/8/87	8.485%	8.397% qtr.
*Kansas Electric #216	7/8	560,000.00	1/2/18	10.375%	10.244% qtr.
*Colorado Ute Electric #96	7/8	1,084,000.00	7/8/87	8.485%	8.397% qtr.
Wolverine Power #182	7/10	2,427,000.00	7/11/88	8.985%	8.886% qtr.
Wolverine Power #183	7/10	3,146,000.00	7/11/88	8.985%	8.886% qtr.
*Wabash Valley Power #104	7/10	4,651,000.00	7/10/87	8.645%	8.554% qtr.
*Wabash Valley Power #206	7/11	8,665,000.00	7/13/87	8.675%	8.583% qtr.
Wolverine Power #234	7/11	9,763,000.00	7/13/87	8.675%	8.583% qtr.
Tri-State G&T #177	7/12	2,500,000.00	12/31/19	10.591%	10.454% qtr.
*Colorado Ute Electric #168	7/12	130,295.00	7/12/87	8.855%	8.759% qtr.
*New Hampshire Electric #192	7/15	1,202,000.00	12/31/17	10.597%	10.460% qtr.
Deseret G&T #211	7/15	8,396,000.00	7/15/87	8.905%	8.808% qtr.
*Oglethorpe Power #246	7/15	18,117,000.00	12/31/17	10.597%	10.460% qtr.

*maturity extension
+rollover

FEDERAL FINANCING BANK

JULY 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
RURAL ELECTRIFICATION ADMINISTRATION (Cont'd)					
*East Kentucky Power #188	7/15	$ 4,500,000.00	1/2/18	10.597%	10.460% qtr.
*Colorado Ute Electric #71	7/15	1,190,000.00	7/15/87	8.905%	8.808% qtr.
*Sho-Me Power #164	7/15	500,000.00	1/2/18	10.597%	10.460% qtr.
*East Kentucky Power #188	7/16	7,090,000.00	12/31/15	10.603%	10.466% qtr.
Sho-Me Power #164	7/17	500,000.00	12/31/19	10.535%	10.398% qtr.
*Cajun Electric #197	7/17	19,000,000.00	7/17/88	9.195%	9.092% qtr.
*New Hampshire Electric #192	7/17	1,125,000.00	1/2/18	10.538%	10.403% qtr.
*New Hampshire Electric #192	7/17	1,253,000.00	1/2/18	10.538%	10.403% qtr.
*New Hampshire Electric #192	7/17	1,765,000.00	1/2/18	10.538%	10.403% qtr.
*Colorado Ute Electric #96	7/18	1,230,000.00	7/20/87	8.765%	8.671% qtr.
Corn Belt Power #292	7/18	343,000.00	1/2/18	10.508%	10.373% qtr.
S. Mississippi Electric #90	7/18	884,000.00	9/30/87	8.823%	8.728% qtr.
Oglethorpe Electric #246	7/18	19,922,000.00	12/31/19	10.495%	10.361% qtr.
East Kentucky Power #73	7/18	5,726,135.26	12/31/15	10.506%	10.372% qtr.
East Kentucky Power #73	7/18	495,169.08	12/31/15	10.516%	10.381% qtr.
East Kentucky Power #140	7/18	640,000.00	12/31/14	10.519%	10.384% qtr.
East Kentucky Power #140	7/18	430,000.00	12/31/16	10.508%	10.373% qtr.
East Kentucky Power #140	7/18	600,000.00	12/31/16	10.508%	10.373% qtr.
East Kentucky Power #140	7/18	5,900,000.00	12/31/19	10.494%	10.360% qtr.
East Kentucky Power #140	7/18	1,130,000.00	12/31/19	10.495%	10.361% qtr.
East Kentucky Power #188	7/18	4,069,000.00	12/31/16	10.508%	10.373% qtr.
East Kentucky Power #188	7/18	8,126,000.00	12/31/16	10.508%	10.373% qtr.
East Kentucky Power #291	7/18	600,000.00	12/31/15	10.512%	10.377% qtr.
New Hampshire Electric #270	7/19	439,000.00	1/2/18	10.665%	10.526% qtr.
Kepco #282	7/22	680,000.00	12/31/15	10.670%	10.531% qtr.
S. Mississippi Electric #288	7/22	10,173,500.00	9/30/87	9.045%	8.945% qtr.
S. Mississippi Electric #289	7/22	1,026,500.00	9/30/87	9.065%	8.965% qtr.
*Sunflower Electric #174	7/22	752,000.00	1/2/18	10.705%	10.565% qtr.
*Big Rivers Electric #143	7/22	340,000.00	12/31/17	10.705%	10.565% qtr.
*Big Rivers Electric #179	7/22	1,683,000.00	12/31/17	10.705%	10.565% qtr.
*East Kentucky Power #73	7/22	1,193,000.00	12/31/15	10.712%	10.572% qtr.
Vermont Electric #259	7/23	1,019,000.00	12/31/19	10.784%	10.642% qtr.
Allegheny Electric #304	7/24	265,000.00	9/30/87	9.185%	9.082% qtr.
*S. Mississippi Electric #3	7/24	215,000.00	12/31/10	10.685%	10.546% qtr.
*S. Mississippi Electric #4	7/24	445,000.00	12/31/12	10.694%	10.555% qtr.
*Upper Missouri G&T #172	7/24	885,000.00	7/24/87	9.105%	9.004% qtr.
Western Farmers Electric #285	7/26	9,215,000.00	1/3/17	10.857%	10.714% qtr.
Washington Electric #269	7/26	136,000.00	9/30/87	9.164%	9.061% qtr.
*Basin Electric #232	7/29	953,000.00	12/3/85	7.695%	7.644% qtr.
*Tex-La Electric #208	7/29	820,000.00	1/2/18	10.925%	10.780% qtr.
North Carolina Electric #268	7/30	7,521,000.00	9/30/87	9.255%	9.150% qtr.
Plains Electric #158	7/31	29,000.00	12/31/19	10.960%	10.814% qtr.
Plains Electric #300	7/31	1,045,000.00	12/31/16	10.882%	10.738% qtr.
Kamo Electric #266	7/31	551,000.00	12/31/15	10.885%	10.741% qtr.
*Basin Electric #87	7/31	1,099,000.00	12/3/85	7.755%	7.704% qtr.
*Basin Electric #88	7/31	226,000.00	12/3/85	7.755%	7.704% qtr.
*Southern Illinois Power #38	7/31	1,000,000.00	9/30/87	9.251%	9.146% qtr.
SMALL BUSINESS ADMINISTRATION					
State & Local Development Company Debentures					
No. Oklahoma S.B.D. Corp.	7/10	48,000.00	7/1/00	10.133%	
Gr. Eastern Oregon Dev. Corp.	7/10	53,000.00	7/1/00	10.133%	
Cleveland Area Dev. Fin. Corp.	7/10	71,000.00	7/1/00	10.133%	
City-Wide Sm. Bus. Dev. Corp.	7/10	76,000.00	7/1/00	10.133%	
Louisville Ec. Dev. Corp.	7/10	79,000.00	7/1/00	10.133%	
Middle Monongahela I.D.A.	7/10	105,000.00	7/1/00	10.133%	
Cleveland Area Dev. Fin. Corp.	7/10	126,000.00	7/1/00	10.133%	
Kansas City Corp. for Ind. Dev.	7/10	158,000.00	7/1/00	10.133%	
South Dakota Dev. Corp.	7/10	168,000.00	7/1/00	10.133%	
South Shore Economic Dev. Corp.	7/10	189,000.00	7/1/00	10.133%	

*maturity extension

FEDERAL FINANCING BANK

JULY 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
State & Local Development Company Debentures (Cont'd)					
Greater Pocatello Dev. Corp.	7/10	$ 194,000.00	7/1/00	10.133%	
Ohio Statewide Dev. Corp.	7/10	215,000.00	7/1/00	10.133%	
Georgia Mountains Reg. E.D.C.	7/10	218,000.00	7/1/00	10.133%	
Atlanta Local Dev. Co.	7/10	256,000.00	7/1/00	10.133%	
Evergreen Community Dev. Assoc.	7/10	315,000.00	7/1/00	10.133%	
Gr. Metro. Chicago Dev. Corp.	7/10	353,000.00	7/1/00	10.133%	
St. Joseph County CDC	7/10	404,000.00	7/1/00	10.133%	
Chester County S.B.A. Corp.	7/10	498,000.00	7/1/00	10.133%	
Corp. for B.A. in New Jersey	7/10	500,000.00	7/1/00	10.133%	
Montgomery County B.D.C.	7/10	500,000.00	7/1/00	10.133%	
Gr. Metro. Chicago Dev. Corp.	7/10	500,000.00	7/1/00	10.133%	
St. Louis Local Dev. Co.	7/10	18,000.00	7/1/05	10.343%	
Gr. Southwest Kansas CDC	7/10	20,000.00	7/1/05	10.343%	
Mentor Econ. Assistance Corp.	7/10	32,000.00	7/1/05	10.343%	
St. Louis L.D.C.	7/10	42,000.00	7/1/05	10.343%	
St. Louis L.D.C.	7/10	42,000.00	7/1/05	10.343%	
St. Louis County L.D.C.	7/10	44,000.00	7/1/05	10.343%	
St. Louis L.D.C.	7/10	45,000.00	7/1/05	10.343%	
Sowega Economic Dev. Corp.	7/10	48,000.00	7/1/05	10.343%	
Oakland County Local Dev. Co.	7/10	49,000.00	7/1/05	10.343%	
Nine County Dev., Inc.	7/10	63,000.00	7/1/05	10.343%	
Sm. Business Services, Inc.	7/10	65,000.00	7/1/05	10.343%	
Provo Metropolitan CDC	7/10	76,000.00	7/1/05	10.343%	
Columbus Countywide Dev. Corp.	7/10	77,000.00	7/1/05	10.343%	
Oakland County Local Dev. Co.	7/10	86,000.00	7/1/05	10.343%	
Enterprise Dev. Corp.	7/10	87,000.00	7/1/05	10.343%	
Cascades W. Fin. Services, Inc.	7/10	88,000.00	7/1/05	10.343%	
Covington First Dev. Corp.	7/10	104,000.00	7/1/05	10.343%	
Hamilton County Dev. Co., Inc.	7/10	105,000.00	7/1/05	10.343%	
Chicago Industrial Fin. Corp.	7/10	112,000.00	7/1/05	10.343%	
Provo Metropolitan CDC	7/10	117,000.00	7/1/05	10.343%	
Treasure Valley CDC	7/10	121,000.00	7/1/05	10.343%	
Greater Southwest Kansas CDC	7/10	126,000.00	7/1/05	10.343%	
Birmingham City Wide Dev. Co.	7/10	166,000.00	7/1/05	10.343%	
Ocean State B.D.A., Inc.	7/10	168,000.00	7/1/05	10.343%	
San Diego County L.D.C.	7/10	181,000.00	7/1/05	10.343%	
St. Louis County L.D.C.	7/10	185,000.00	7/1/05	10.343%	
Treasure Valley C.D.C.	7/10	187,000.00	7/1/05	10.343%	
E.D.F. of Sacramento, Inc.	7/10	188,000.00	7/1/05	10.343%	
Provo Metropolitan Dev. Co.	7/10	198,000.00	7/1/05	10.343%	
Gr. Salt Lake Bus. Dis.	7/10	204,000.00	7/1/05	10.343%	
Evergreen Community Dev. Assoc.	7/10	205,000.00	7/1/05	10.343%	
Los Angeles LDC, Inc.	7/10	208,000.00	7/1/05	10.343%	
San Francisco Indus. Dev. Fund	7/10	231,000.00	7/1/05	10.343%	
Verd-Ark-Ca Dev. Corp.	7/10	232,000.00	7/1/05	10.343%	
Milwaukee Ec. Dev. Corp.	7/10	252,000.00	7/1/05	10.343%	
Enterprise Dev. Corp.	7/10	273,000.00	7/1/05	10.343%	
Long Island Dev. Corp.	7/10	300,000.00	7/1/05	10.343%	
Long Island Dev. Corp.	7/10	335,000.00	7/1/05	10.343%	
San Diego County L.D.C.	7/10	340,000.00	7/1/05	10.343%	
Evergreen Community Dev. Assoc.	7/10	385,000.00	7/1/05	10.343%	
Michigan Cert. Dev. Corp.	7/10	409,000.00	7/1/05	10.343%	
Columbus Countywide Dev. Corp.	7/10	420,000.00	7/1/05	10.343%	
Metro. Growth & Dev. Corp.	7/10	481,000.00	7/1/05	10.343%	
Cen. Vermont Ec. Dev. Corp.	7/10	500,000.00	7/1/05	10.343%	
Phoenix Local Dev. Corp.	7/10	500,000.00	7/1/05	10.343%	
Alabama Community Dev. Corp.	7/10	500,000.00	7/1/05	10.343%	
Corp. of E.D. in Des Moines	7/10	43,000.00	7/1/10	10.446%	
Warren Redev. & Plan. Corp.	7/10	47,000.00	7/1/10	10.446%	
Treasure Valley C.D.C.	7/10	67,000.00	7/1/10	10.446%	
Wilmington Local Dev. Corp.	7/10	70,000.00	7/1/10	10.446%	
Gr. Muskegon Indus. Fund, Inc.	7/10	71,000.00	7/1/10	10.446%	
Central Ozarks Dev., Inc.	7/10	74,000.00	7/1/10	10.446%	
Southern Dev. Council, Inc.	7/10	80,000.00	7/1/10	10.446%	
Nevada State Dev. Corp.	7/10	83,000.00	7/1/10	10.446%	
The Southern Dev. Council, Inc.	7/10	97,000.00	7/1/10	10.446%	
San Diego County L.D.C.	7/10	102,000.00	7/1/10	10.446%	

FEDERAL FINANCING BANK

JULY 1985 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
State & Local Development Company Debentures (Cont'd)					
New Haven Com. Investment Corp.	7/10	$ 109,000.00	7/1/10	10.446%	
BEDCO Development Corp.	7/10	112,000.00	7/1/10	10.446%	
Corp. for B.A. in New Jersey	7/10	114,000.00	7/1/10	10.446%	
S. Cen. Tennessee B.D.C.	7/10	126,000.00	7/1/10	10.446%	
Community E.D.C. of Colorado	7/10	139,000.00	7/1/10	10.446%	
Charlotte Cert. Dev. Corp.	7/10	147,000.00	7/1/10	10.446%	
Texas Panhandle Reg. Dev. Corp.	7/10	156,000.00	7/1/10	10.446%	
Allentown Ec. Dev. Corp.	7/10	181,000.00	7/1/10	10.446%	
Arrowhead Reg. Dev. Corp.	7/10	181,000.00	7/1/10	10.446%	
Union City Ec. Dev. Corp.	7/10	186,000.00	7/1/10	10.446%	
St. Louis Local Dev. Corp.	7/10	189,000.00	7/1/10	10.446%	
Chicago Indus. Finance Corp.	7/10	192,000.00	7/1/10	10.446%	
Corp. for B.A. in New Jersey	7/10	221,000.00	7/1/10	10.446%	
Gr. Spokane Bus. Dev. Assoc.	7/10	236,000.00	7/1/10	10.446%	
1st District Development Corp.	7/10	244,000.00	7/1/10	10.446%	
San Diego County L.D.C.	7/10	253,000.00	7/1/10	10.446%	
South Shore Ec. Dev. Corp.	7/10	257,000.00	7/1/10	10.446%	
Bay Colony Dev. Corp.	7/10	265,000.00	7/1/10	10.446%	
Seda-Cog Local Dev. Corp.	7/10	436,000.00	7/1/10	10.446%	
Massachusetts Cert. Dev. Corp.	7/10	474,000.00	7/1/10	10.446%	
Kisatchie-Delta RP&D Dis., Inc.	7/10	483,000.00	7/1/10	10.446%	
Gr. Eastern Oregon Dev. Corp.	7/10	498,000.00	7/1/10	10.446%	
Railbelt Community Dev. Corp.	7/10	500,000.00	7/1/10	10.446%	
Bay Area Bus. Dev. Company	7/10	500,000.00	7/1/10	10.446%	
Evergreen Community Dev. Assoc.	7/10	500,000.00	7/1/10	10.446%	
Small Business Investment Company Debentures					
Brantman Capital Corp.	7/24	150,000.00	7/1/88	9.485%	
Marcon Capital Corporation	7/24	450,000.00	7/1/90	9.985%	
Albuquerque Small Bus. Inv. Co.	7/24	250,000.00	7/1/92	10.425%	
Jupiter Partners	7/24	500,000.00	7/1/92	10.425%	
Ritter Partners	7/24	500,000.00	7/1/92	10.425%	
Alliance Bus. Investment Co.	7/24	710,000.00	7/1/95	10.585%	
Bus. Cap. Corp. of Arlington	7/24	300,000.00	7/1/95	10.585%	
California Cap. Investors, Ltd.	7/24	600,000.00	7/1/95	10.585%	
Clinton Capital Corp.	7/24	1,500,000.00	7/1/95	10.585%	
Enterprise Capital Corp.	7/24	1,550,000.00	7/1/95	10.585%	
Gold Coast Capital Corp.	7/24	200,000.00	7/1/95	10.585%	
J & D Capital Corporation	7/24	300,000.00	7/1/95	10.585%	
Jupiter Partners	7/24	500,000.00	7/1/95	10.585%	
Kitty Hawk Capital, Ltd.	7/24	1,500,000.00	7/1/95	10.585%	
Norwest Growth Fund, Inc.	7/24	1,000,000.00	7/1/95	10.585%	
Red River Ventures, Inc.	7/24	500,000.00	7/1/95	10.585%	
Ritter Partners	7/24	500,000.00	7/1/95	10.585%	
Shared Ventures, Inc.	7/24	300,000.00	7/1/95	10.585%	
United Mercantile Cap. Corp.	7/24	300,000.00	7/1/95	10.585%	
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
*Note A-85-10	7/31	471,945,498.61	10/31/85	7.625%	

*maturity extension

FEDERAL FINANCING BANK
JULY 1985 Commitments

BORROWER	GUARANTOR	AMOUNT	COMMITMENT EXPIRES	MATURITY
Brownsville, TX	HUD	$ 1,200,000.00	9/1/86	9/1/92
Montgomery, PA	HUD	4,000,000.00	5/15/87	5/15/93
Alaska Electric	REA	18,120,000.00	7/24/90	12/31/16

FEDERAL FINANCING BANK HOLDINGS
(in millions)

Program	July 31, 1985	June 30, 1985	Net Change 7/1/85-7/31/85	Net Change--FY 1985 10/1/84-7/31/85
On-Budget Agency Debt				
Tennessee Valley Authority	$ 14,463.0	$ 14,750.0 R	$ -287.0	$ 1,028.0
Export-Import Bank	15,728.8	15,728.8	-0-	38.9
NCUA-Central Liquidity Facility	225.2	219.5 R	5.7	-43.6
Off-Budget Agency Debt				
U.S. Postal Service	720.0	720.0	-0-	-367.0
U.S. Railway Association	73.8	73.8	-0-	22.5†
Agency Assets				
Farmers Home Administration	63,546.0	62,606.0	940.0	4,035.0
DHHS-Health Maintenance Org.	109.0	112.2	-3.3	-7.1
DHHS-Medical Facilities	126.1	132.0	-5.8	-5.8
Overseas Private Investment Corp.	6.1	6.1	-0-	-4.8
Rural Electrification Admin.-CBO	3,536.7	3,536.7	-0-	-0-
Small Business Administration	33.8	34.5	-0.6	-6.3
Government-Guaranteed Lending				
DOD-Foreign Military Sales	18,087.3	17,993.4	94.0	976.4
DEd.-Student Loan Marketing Assn.	5,000.0	5,000.0	-0-	-0-
DOE-Geothermal Loan Guarantees	12.4	12.4	-0-	6.2
DOE-Non-Nuclear Act (Great Plains)	1,536.9	1,466.5	70.4	246.9
DHUD-Community Dev. Block Grant	292.8	268.1 R	24.7	84.5
DHUD-New Communities	33.5	33.5	-0-	-0-
DHUD-Public Housing Notes	2,146.2	2,146.2	-0-	-32.3
General Services Administration	408.6	408.6	-0-	-4.7
DOI-Guam Power Authority	35.6	35.6	-0-	-0.4
DOI-Virgin Islands	28.2	28.3	-0.1	-0.5
NASA-Space Communications Co.	887.6	887.6	-0-	-67.0
DON-Ship Lease Financing	1,003.2	1,060.8	-57.5	1,003.2
DON-Defense Production Act	5.4	5.1	0.3	2.3
Oregon Veteran's Housing	60.0	60.0	-0-	60.0
Rural Electrification Admin.	21,364.1	21,182.5	181.6	777.1
SBA-Small Business Investment Cos.	980.5	974.6	5.9	120.2
SBA-State/Local Development Cos.	565.3	546.0	19.3	210.7
TVA-Seven States Energy Corp.	1,611.4	1,611.9	-0.5	55.9
DOT-Section 511	153.6	153.6	-0-	-6.0
DOT-WMATA	177.0	177.0	-0-	-0-
TOTALS*	$ 152,958.2	$ 151,971.2 R	$ 987.0	$ 8,122.1

*figures may not total due to rounding
†reflects adjustment for capitalized interest
R = revised

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

For Release Upon Delivery
Expected at 10:00, E.D.T.
September 16, 1985

STATEMENT OF
J. ROGER MENTZ
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE SUBCOMMITTEE ON TAXATION
AND DEBT MANAGEMENT
OF THE SENATE COMMITTEE ON FINANCE

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to discuss S.376, the "Child Health Incentives Reform Plan." This bill would amend the Internal Revenue Code to disallow an employer a deduction for expenses relating to a group health plan unless such plan includes preventive health care for the children of employees. For the reasons stated below, the Treasury Department does not support this proposal.

Current Law

The Federal tax law provides tax advantages designed to encourage an employer to provide, and employees to accept, a portion of compensation in the form of health insurance. More specifically, under current law, an employer's contributions to a group health plan for its employees and benefits and reimbursements provided under such a plan are excluded from an employee's income and wages for Federal income tax and employment tax purposes. In addition, an employer may deduct the cost of these excludable contributions and benefits.

The tax law generally does not currently constrain employer and employee flexibility in the design of employer health plans. The only constraints include the following: (i) an employer may not deduct health plan expenses if the plan differentiates in its benefits on the basis of whether an individual has end stage renal disease; (ii) a highly compensated employee may not exclude from gross income a benefit provided under a self-insured health plan unless the

plan satisfies certain nondiscrimination requirements; and (iii) an employee may not exclude from gross income a benefit or reimbursement provided under a health plan (whether or not self-insured) unless the benefit or reimbursement is for the "medical care" of the employee, his or her spouse, and his or her dependents. "Medical care" is defined for this purpose to include the diagnosis, cure, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body.

Thus, under current tax law an employer may choose to maintain or not to maintain a group health plan for its employees. An employer that chooses to maintain a plan, with the exception of satisfying any applicable nondiscrimination rules, may determine which health services and expenses are covered, the appropriate level of deductible and co-payment requirements for each type of expense, the extent to which covered expenses should be restricted to selected health providers, the benefit options that should be made available to employees, and how costs should be allocated between the employer and employees. Of course, employees are able to affect an employer's decisions on these and related questions through the labor market and the collective bargaining process. Also, an employee may be able to design his or her own health benefit package through a cafeteria plan.

S.376: The Child Health Incentives Reform Plan

The Child Health Incentives Reform Plan would require that an employer-maintained group health plan provide employees with coverage for "pediatric preventive health care" as a condition of the employer's deduction for any expenses related to such plan. This rule would apply without regard to whether the employer's health expenses are in the form of payments to an insurance company or health services provider (including a health maintenance organization), contributions to a welfare benefit fund, or direct reimbursements to employees.

Under the bill, "pediatric preventive health care" would include the following types of periodic care provided to children under the age of 21: determinations of health and development history, comprehensive unclothed physical examinations, developmental and behavioral assessments, immunizations appropriate for age, health, and developmental history, laboratory procedures appropriate for age and population groups, and appropriate vision and hearing testing and referral for treatment as necessary. In addition, the bill permits the Treasury Department to require by regulation, after consulting with the Secretary of Health and Human Services and appropriate child care medical organizations, that a plan provide additional types of pediatric preventive care.

Discussion

The Treasury Department does not support the proposed legislation. With the exception of requiring that an employer health plan satisfy appropriate nondiscrimination rules, we do not believe that the Federal government should use the tax system to regulate group health plans provided by employers for employees. (On the nondiscrimination issue, as part of Fundamental Tax Reform, the President has proposed that uniform nondiscrimination rules apply to all tax-favored welfare benefits, including tax-favored health benefits provided under a contract with an insurance company.)

More specifically, we do not believe that substituting the view of the Federal government, no matter how well intentioned, for the choices of employers and employees about the benefits to be provided under employer health plans will result in a more optimal allocation of compensation and health benefits. In addition, we are concerned that imposing the Federal government's view of a proper employer health plan may impair the flexibility that is so important to the maintenance of an effective and cost efficient health care system. Finally, Federal regulation through the tax system of the benefits to be provided in employer health plans would likely be both duplicative of and inconsistent with state regulation of health insurance.

We recognize that pediatric preventive care may be an important form of health coverage, and that many argue that the broad provision of such care would result in significant long-term health benefits. (We of course are not equipped to evaluate many of these issues, and thus on the pure health questions we defer to the Department of Health and Human Services.) However, such a step by Congress in the regulation of health care provided by employers would make it very difficult for Congress to avoid broader imposition of mandatory health benefit provisions in the tax law.

In our view, the Federal government should not mandate that employer health plans provide any particular types of benefits and thus interfere with the decisions of employers and employees about the forms in which compensation should be provided and about the types and levels of benefits that should be provided under health plans. Certain employers and employees will decide that they prefer increased cash compensation over increased health coverage. Also, employers and employees will conclude that, within their cost constraints, one particular type of health coverage is more important than another. For example, an employer and its employees may well prefer to spend the health care dollars on catastrophic coverage rather than on lower deductible and co-payment requirements for other health expenses. Another employer and its employees may prefer to purchase increased preventive care coverage in exchange for reduced catastrophic

coverage or for higher deductibles. Because employers and employees have different compensation, health, and cost needs and constraints, decisions about the appropriate mix and levels of particular forms of compensation, including types of health benefits, are most appropriately made at the employer and employee levels.

We do not believe that the provision of tax advantages with respect to employer health plans justifies the Federal government mandating that such plans provide particular types of health benefits. Through the existing tax incentives, Congress has expressed its policy view that employers should be encouraged to provide a portion of employees' compensation in the form of health benefits. The result has been the successful extension of health coverage to a large portion of this country's employees. It would be in our view a distortion of the original policy of the current tax advantages for the Federal government to substitute its determination of the proper mix among health benefits for the decisions of employers and employees.

In addition, we are concerned that increased Federal regulation of employer health plans of the type proposed in S.376 would interfere with the flexibility that is so crucial to an effective health care system. Medical technology and practice are rapidly changing, and health costs are not easily predictable or controllable. Flexibility thus is crucial to the maintanence of a health plan that delivers the proper mix and levels of health benefits in a cost effective manner. In our view, mandating types of health benefits would limit this flexibility and inhibit both technological and practice innovations and cost containment efforts, many of which may well be consistent with prudent health and economic policy, and thus would likely harm the overall quality of the group health system.

Furthermore, in our view, for the Federal government to embark on the path of conditioning an employer's deduction of compensatory health-related expenses on the provision of particular types of benefits would be an intrusion into an area of responsibility already delegated to the states. Several states currently regulate the insurance contracts under which health benefits may be provided to employees by requiring that such contracts provide certain types of coverage, e.g., coverage for children beginning at birth, rather than shortly after birth, and coverage for services rendered by a particular type of health provider. Congress' desire that the Federal government not interfere with state regulation in this area is expressed in various laws, including the McCarran-Ferguson Act, the Employee Retirement Income Security Act of 1974, and the National Labor Relations Act. Unless the states' authority to regulate health insurance is preempted, Federal regulation would result in a second layer of mandated benefits, which would inevitably be duplicative of and inconsistent with state regulation.

Federal preemption of course should not be undertaken without a full examination of the benefits currently provided to employees, the current extent of state regulation, and the various health, economic, and tax policies that would be affected by Federal preemption and regulation.

The proposed legislation contains several technical uncertainties that require clarification. For instance, the bill requires a plan to provide pediatric preventive health care to any child who has not attained the age of 21. We assume that this requirement would be satisfied if the plan provided pediatric preventive care to only the children of those employees who participate in the plan. How is this rule intended to apply, however, if the plan does not provide family coverage, but rather only coverage for the employees? In addition, is the requirement satisfied if pediatric preventive care is available under the plan, but some employees with children elect not to purchase this benefit?

Another uncertain aspect of the bill is whether a health plan could apply a deductible or co-payment requirement with respect to pediatric preventive care? Would a plan satisfy the proposed rule if only pediatric preventive care expenses in excess of $100 were covered? What about a plan that did not have a separate deductible for pediatric preventive care, but rather contained a $100 or $200 deductible for all health benefits, including pediatric preventive care? Analogous issue arise with respect to co-payment requirements.

Finally, the bill does not in our view adequately describe the various types of medical services that are to be considered pediatric preventive health care. For example, the most frequently used term in the bill is "appropriate," a term that provides little guidance. We recognize that it is difficult to describe the specific types of preventive care that a health plan should provide; the health field is a dynamic one and concrete descriptions risk becoming outdated in a very short time. Indeed, the dynamism of the health field is one of the principal reasons that we do not believe the approach of S.376 is either workable or prudent. Nevertheless, if the approach of S.376 is to be undertaken, additional specificity of description is necessary.

In conclusion, for the various policy reasons set forth above, the Treasury Department does not support the enactment of S.376.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. September 17, 1985

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $9,000 million, to be issued September 26, 1985. This offering will result in a paydown for the Treasury of about $5,100 million, as the maturing bills are outstanding in the amount of $14,093 million. The size of this offering has been reduced from recent levels in order to ensure that the current debt ceiling is not exceeded. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, September 23, 1985. The two series offered are as follows:

91-day bills (to maturity date) for approximately $4,500 million, representing an additional amount of bills dated December 27, 1984, and to mature December 26, 1985 (CUSIP No. 912794 HQ 0), currently outstanding in the amount of $15,626 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $4,500 million, to be dated September 26, 1985, and to mature March 27, 1986 (CUSIP No. 912794 JY 1).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing September 26, 1985. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. Federal Reserve Banks currently hold $1,593 million as agents for foreign and international monetary authorities, and $2,743 million for their own account. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

B-279

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M. September 17, 1985

TREASURY POSTPONES AUCTIONS OF 4-YEAR NOTES, 7-YEAR NOTES, AND 20-YEAR 1-MONTH BONDS

The Department of the Treasury stated today that the auctions of 4-year notes, 7-year notes, and 20-year 1-month bonds, which would normally be held next week, have been postponed pending Congressional action on the debt limit bill.

Interested investors are requested to look for notice of the scheduling of these auctions in the financial press or to contact their local Federal Reserve Bank for such information.

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TREASURY NEWS

partment of the Treasury • Washington, D.C. • Telephone 566-2041

Statement by
The Honorable
David C. Mulford
Assistant Secretary of the Treasury
for International Affairs
Before the
Subcommittee on Foreign Operations
Committee on Appropriations
United States Senate
September 18, 1985

Environmental Aspects of Multilateral Development Bank Operations

Mr. Chairman and Members of the Committee, I appreciate the opportunity to discuss with you the environmental aspects of the multilateral development bank (MDB) lending operations. The MDBs are important to U.S. foreign policy as the single largest source of development assistance in the world, but in the environmental area their performance has been mixed.

After describing our perception of the pattern of project problems that have come to light, I will outline the institutional shortcomings which the MDBs appear to share at this time and discuss some steps that might be taken in the future.

At the outset, I should make clear that the Treasury Department is not an agency of government charged with maintaining a full scale professional capability to manage the possible environmental issues. We have approached the set of issues that I will be describing in a laymen's way, while drawing on the competence which resides in other U.S. agencies and in public interest organizations.

Our attention has been forcefully drawn to the environmental implications of MDB projects by a series of hearings in the Congress over the last two years and by the energetic efforts of spectrum of U.S. environmental organizations. This Committee has held hearings and expressed forceful concern over these issues. The breadth and intensity of public and Congressional interest appears to us consistent with the severity of the problems we have encountered.

Our objective is to encourage the MDBs themselves to strengthen their in-house capability to manage these issues, so that the intense attention which has been devoted to this subject in the last two years becomes superfluous and can be diminished.

The Pattern of Environmental Problems

Three traditional areas of MDB lending have been the focus of attention: hydroelectric and multi-purpose dam projects in tropical regions, penetration road projects into relatively uninhabited regions and agriculture and rural development projects. Projects in these sectors have involved significant effects on human health and on the management of natural resources in countries which borrow from the MDBs. While occasionally our attention has been drawn to environmental issues in other lending sectors -- for example, the management of municipal pollution and cross-border effects on neigboring countries in connection with water and sewage projects -- these have not been the subject of intense concern in the public discussion of the last two years to which we are addressing ourselves here today.

Large impoundments of rivers in tropical countries -- whether for hydroelectric, irrigation, flood control or other purposes -- are substantial investments. Project cost is rarely less than $100 million and often involves many billions of dollars. During fiscal year 1984, the MDBs approved ten projects related to dam construction, which accounted for $1,262.3 million, or about six percent of total commitments.

The environmental problems associated with water impoundments in tropical regions have been serious and several. These include deterioration of water quality, siltation problems, and threats to human health and well-being.

When the lush vegetation of tropical forests has been left in an impoundment and the reservoir of water is subsequently filled, the vegetable matter undergoes slow decay underwater with a minimum of oxygen availability. These conditions can lead to a severe deterioration in water quality, affecting power generation equipment as well as the usefulness of

water for irrigation and human consumption. In extreme conditions, a large impoundment with decaying vegetation and relatively small amounts of water entering and leaving the reservoir can develop into an ideal growing area for prolific water plants, such as water hyacinth or water lettuce. These plants can deprive fish of oxygen, curtailing any incidental fishery benefits that might have been envisioned for a project, and can become entangled in power generation equipment, substantially increasing maintenance and replacement costs. An appropriate mitigatory measure to avoid these water quality problems is to remove the existing vegetation prior to filling the reservoir. In cases where the cost of completely clearing a reservoir area would be prohibitive, removing a substantial portion may suffice to ensure appropriate water quality.

The most dramatic examples of impoundments with water quality problems are now several decades old, but the associated costs remain severe. Frequent replacement of power generating equipment and expensive, repetitive removal of floating vegetation can significantly reduce the expected benefits from the project. The Kariba Dam in Zambia, partially financed by an $80 million IBRD loan in 1956, and the Volta Hydroelectric Development project, partially supported by a 1961 $47 million IBRD loan, are examples.

More currently, a large hydroelectric dam project on the Sinu River in Colombia, known as Urra II and under discussion in the IBRD and IDB over the last four years, would raise similar water quality concerns. The Colombia project was recently deferred for financial reasons. During the planning process, the IDB has estimated that 20 percent vegetation removal from the reservoir basin would be adequate, although water quality problems would remain.

The MDBs and the international civil engineering community are aware of the problems which can occur when vegetation is not removed from a reservoir, but the cost of the undertaking in remote areas sometimes encourages running some risks with the expectation that the body of water will be purified as time passes.

A second problem associated with impoundment projects is siltation. If the watershed surrounding the river system feeding a reservoir is not protected, there is a severe risk that the heavy rains often occuring in tropical regions will lead to soil erosion, carrying sediment into the reservoir and turning an impoundment into a large mud puddle. The useful life of hydroelectric generating facilities can be drastically curtailed, unless an expensive investment in dredging the reservoir is undertaken. An appropriate mitigatory measure is to ensure that land use in the river basin is limited to activities that retain vegetation which holds the topsoil. Selective forest industries, appropriate agro-forest industries, or preservation in national parks or forests are uses that can provide effective watershed protection.

Siltation has shortened the effective life of some dams, but has more frequently led to costly efforts to offset negative effects. The classic case is the 1953 $3.5 million IBRD loan for the Anchicaya hydroelectric dam in Colombia. The dam was virtually unusable because of siltation only seven years after completion and has since been abandoned.

In more recent years, projects have continued to be put forward for funding without provisions to ensure adequate watershed protection. Although the severity of the problem is often acknowledged through the inclusion of a requirement for the future formulation of a watershed protection plan, such a plan is rarely in place prior to project approval and is frequently delayed, risking the productivity of the project.

The 1979 IDB loan to finance construction of the Paute hydroelectric dam in Ecuador recognized a severe siltation problem which would render the facility unusable in about seven years if unaddressed. The plan in 1979 was to build a dam upstream with a larger reservoir capacity to trap the silt. Construction of the Paute dam has not yet been completed, but plans for the upstream dam appear to have been shelved. A 1984 IDB project to finance several elements of hydroelectric production in the Dominican Republic, including the Tavera dam, required the development of a watershed protection plan during dam construction, but land acquisition may be a problem. The risk in a significant delay in formulation and implementation of the watershed plan is that current siltation levels would lead to interference in electrical production within twelve years of dam completion.

A third set of problems associated with impoundments has been the severe effects on human health and well-being from some projects. The still waters associated with reservoirs are often ideal breeding grounds for the snail that acts as the intermediary host for the shistosomiasis bacteria. Since the disease affects some 250 million people in the tropics worldwide, its incidence ought to be a systematically examined aspect of dam planning. Onchocerciasis, or river blindness, has also been associated with dam construction in the tropics. Measures to control the incidence of these diseases require planning and steady application; cures are uncertain and expensive.

The IBRD and AFDB supported the Nangbeto dam project in Togo which was approved in 1984 and was expected to yield an increase in the incidence of shistosomiasis. While a study of health needs was included in the project proposal, completion of such studies prior to project approval would have been preferable with the needed mitigatory measures identified and necessary funding included.

A second major effect of dam projects on human well being is the requirement to resettle the inhabitants of areas to be flooded by creation of the reservoir. Such resettlement -- typically of small rural farmers and often of ethnic or cultural minorities -- can be socially and politically disruptive unless planned and executed with care.

In March 1985, the IBRD Board approved the first of several projects for the water development of the Narmada River Basin in the west of India. More than 150,000 persons -- many minority group members -- will require relocation. Bank and Indian Government planning for relocation has been extensive. However, available information suggests that provisions to deal with those who own no land -- a sizable portion of the population -- may not be adequate; the provisions consist of a requirement that the state governments find suitable employment. Press reports this summer indicate continuing severe unrest related to the treatment of the minority groups to be displaced. In the El Cajon dam project in Honduras, supported by the IBRD and IDB, relocation was delayed for four years and the approximately one thousand families were finally moved about one year ago -- only days before the dam was to close and the reservoir began filling.

By contrast, in the IDB-supported Colbun-Machicura dam in Chile, the purchase of land from and resettlement of approximately 100 families was well underway at the time of project approval in 1984 -- an example of the kind of approach we would prefer seeing.

Penetration roads into relatively undeveloped areas are typically evaluated in MDB loan proposals on the basis of economic savings to those who use existing transportation system. Estimates of future use rarely assume significant changes in economic activity. By contrast, experience suggests that penetration roads will often ignite spontaneous migration from other parts of a country which can lead to substantial agriculture, forestry or other economic activities, often inconsistent with sustainable resource use. When such situations are likely, a more elaborate regional planning strategy, encompassing the full range of economic and social sectors, is needed -- and may yet fall short of rational resource use in the absence of full participation by the public and private interests afffected by in the project. In 1984, there were 13 projects with approximately $425 million in MDB financing which were primarily designed to open new areas. The 1984 total may not be typical of past years since a substantial proportion of transport sector commitments was allocated to maintenance of existing road systems.

The IBRD supported road through the state of Rondonia in Northwest Brazil, with which this Committee is very familiar, and the IDB supported road project in the neighboring state of Acre are projects where severe problems were anticipated and, indeed, have already arisen. In both cases, while the potential problems were acknowledged at the time of project approval, substantial doubts about successful implementation remained and, in retrospect, should have been heeded. Implementation of needed agriculture, forestry, health and Indian protection measures should have preceeded road construction by several years to cope with the pressures from the population influx.

Agriculture and rural development projects raise a range of natural resource use and human health issues: top soil management, irrigation projects associated with water-logging, salinization and the spread of water-borne diseases, and pesticide use that exceeds the farmer's training in safe application. Agriculture represented about 40 percent of total MDB lending in recent years. While all agriculture projects do not involve environmental issues, the frequency is high and the institutional capacity of borrowing countries to manage the issues is often unaddressed.

The series of "transmigration" projects in Indonesia over many which are designed to resettle farmers from densely populated Java and Bali to the outer islands have been supported most recently by a June 1985 $160 million IBRD loan and an October 1984 $60 million ADB livestock project. The fundamental problem with the transmigration effort is that agricultural practices used in the rich volcanic soils of Java tend to be transferred with the settlers to the poor soils of the outer islands. Since the soils are poor, the farmer clears a new plot when yields drop and leaves barren ground behind. The resulting deforestation and soil erosion has substantially reduced the productivity of substantial tracts in the outer islands. The projects have also sometimes involved the removal of ethnically distinct minorities from lands where traditional agricultural practices, hunting and gathering permitted a sustainable economic system.

The IBRD transmigration project was primarily for soil mapping and should lead to an information base that may provide far better policy guidance in the future. The ADB project financed draft livestock which will likely be used for annual crop production -- an inappropriate land use in most parts of the target island of Kalimantan.

An August 1984 $150 million IBRD loan to the Philippines to finance needed imports included substantial amounts for pesticides. By coincidence, in September, a researcher from the International Rice Institute in Manila testified before a Congressional committee regarding the correlation between the twice yearly application of pesticides in a rural area of the Philippines and sharp upswings in the incidence of serious illnesses among working age males in the area. The safety procedures used in pesticide application are thought responsible. In any case, the loan proposal did not include any discussion of the adequacy of pesticide training through the Philippine agricultural extension service.

While a fair number of MDB-supported irrigation projects have been associated an increased incidence of water-borne diseases, such as shistosomiasis, the IBRD in 1984 reported on an already completed 1977 project in Morocco which was associated with a decline in the incidence of this disease because the irrigation canals were covered and the snail intermediary vector was cut off from feeding on vegetation along the canal banks. The construction technique, while expensive, had the added benefit of reducing water loss from evaporation in the dry Moroccan climate.

Is there an institutional problem in the MDBs?

The Treasury Department has been troubled by the environmental aspects of loan proposals sufficiently frequently to conclude that a problem exists. Almost invariably, MDB project staff are familiar with the nature of these environmental problems and with their incidence in various parts of the world. The MDBs generally have favorable salary structures and recruit widely to obtain quality staff. Staff training, while valuable to ensure broad understanding throughout the institution, and additional staff, while in instances appropriate, do not seem to us the principal needs.

Occasionally, we are told that borrowing governments resist environmental measures in projects and the MDBs can not force borrowers to do what they do not want to do. While these conditions may hold on occasion, it seems to us that at least some elements of borrowing governments are frequently charged with specific responsibility for environmental protection and that these elements, if brought into the project preparation and implementation process, would usually be quite supportive of appropriate environmental components in projects. The MDBs could often ask such agencies to implement project components in borrowing countries. Thus, this argument, while possibly valid at certain times and certain places, would not seem to justify accepting the performance in development projects that we are seeing.

The problem seems to us to lie in another direction. The Administration's 1982 assessment concluded that the MDBs tend to overemphasize the quantity of lending rather than the quality. We suspect that the problems encountered in the envronmental aspects of projects may be an instance of such an overemphasis. If environmental considerations threaten expeditious project processing, the environment is assigned low priority and is left to be dealt with later.

The notion that a hydroelectric dam would be presented to an MDB Board without completed engineering plans would be unacceptable. Yet, we frequently are asked to evaluate loan proposals for our Executive Directors where the watershed protection plan remains to be studied. If such a study were to reveal that land acquisition or zoning would be difficult to implement and the dam is already under construction, financial resources may well be wasted because of unaddressed siltation problems. On the other hand, if construction had been delayed, the financial resources could have been shifted to other, more effective uses -- or simply saved. Financial targets of the MDBs might not be met, but development would be sustainable.

A similar point could be made regarding the desirability of adequate multi-sectoral regional planning -- and the possible delay in lending -- in the cases of penetration roads and agricultural development. In the case of agriculture, it seems essential that research and extension services be capable of addressing the environmental risks before the introduction of production technologies which sharply alter land, water and pesticide use. Without effective services, the risk to natural resources and human health seems high in many projects.

During the last two years, we have endeavored to inform MDB Managements and other Board members when we believed that projects included seriously deficient environmental aspects. We have reviewed projects submitted for Board approval, consulted with MDB staffs regarding project details, discussed particularly severe problems with senior management and, of course, brought to attention of others the public discussion which has been taking place in the United States.

We have not opposed most loans, if proposals were otherwise satisfactory, in the belief that MDB Management and other Board members should be given an opportunity to reflect on the problems that are coming to light in public and in the confines of the Board room.

The Next Steps

Our country's experience with the examination of environmental issues as part of the investment planning process suggests that initially public and private institutions resist the methodical requirements. As the value of these methods to anticipate and plan for potential problems has become clear, resistance has diminished.

The MDBs already use extensive project planning techniques in their operations. Environment considerations could be systematically incorporated into MDB planning relatively easily -- and often are. The conspicuous absence of environmental considerations in some projects and the inadequate treatment in other projects has been the central problem. Our conclusion is that projects in environmentally sensitive sectors should only be accepted if environmental aspects have been thought through and if the mitigatory measures necessary for sustainable development have been identified and any necessary funding assured. Were this principle observed, I believe we would find far less dissatisfaction with MDB performance in this area.

We see some progress but it is not enough. Your efforts, Mr. Chairman, have encouraged the World Bank to give high level attention to the difficulties in the implementation of the Northwest Brazil projects. Your Committee and other Committees of the Congress have brought attention to steps that might be taken to strengthen institutional management. Public groups in the United States and in other countries have expressed their views.

I believe these broadly based expressions of concern are beginning to have an effect and that senior Management in the MDBs is beginning to look seriously at what steps might be taken to address the problem. The suggestions that this Committee may offer, that we have put forward, and that others may advance may be useful to MDB Management when specific steps are examined to strengthen project development and implementation. We believe they should be weighed carefully.

Thank you, Mr. Chairman.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE September 18, 1985

RESULTS OF AUCTION OF 2-YEAR NOTES

The Department of the Treasury has accepted $9,255 million of $18,084 million of tenders received from the public for the 2-year notes, Series Z-1987, auctioned today. The notes will be issued September 30, 1985, and mature September 30, 1987.

The interest rate on the notes will be 9%. The range of accepted competitive bids, and the corresponding prices at the 9% interest rate are as follows:

	Yield	Price
Low	9.05%	99.910
High	9.13%	99.767
Average	9.11%	99.803

Tenders at the high yield were allotted 21%.

TENDERS RECEIVED AND ACCEPTED (In Thousands)

Location	Received	Accepted
Boston	$ 77,930	$ 77,930
New York	15,304,850	7,631,500
Philadelphia	44,765	44,765
Cleveland	246,780	246,780
Richmond	88,855	88,855
Atlanta	89,510	89,510
Chicago	1,090,575	383,175
St. Louis	125,870	107,080
Minneapolis	114,325	114,325
Kansas City	149,955	148,360
Dallas	23,270	23,270
San Francisco	718,940	291,250
Treasury	8,375	8,375
Totals	$18,084,000	$9,255,175

The $9,255 million of accepted tenders includes $1,404 million of noncompetitive tenders and $7,851 million of competitive tenders from the public.

In addition to the $9,255 million of tenders accepted in the auction process, $740 million of tenders was also accepted at the average price from Government accounts and Federal Reserve Banks for their own account in exchange for maturing securities. An additional $350 million of maturing securities held by Federal Reserve Banks will be refunded by the issuance of short-term Treasury bills. These Treasury bills will be exchangeable by the Federal Reserve for additional amounts of new 4-year notes, when offered.

B-282

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE UPON DELIVERY
Expected at 9:30 a.m., E.D.T.
Friday, September 20, 1985

STATEMENT OF RONALD A. PEARLMAN
ASSISTANT SECRETARY
(TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

Mr. Chairman, Members of the Subcommittee:

Thank you for the opportunity to appear before you today to report on the analyses that you requested of high income taxpayers, the growth in partnerships, and partnership losses.

I would like to emphasize that the Administration shares the view that a major focus of the tax reform debate is fairness. As the Committee on Ways and Means prepares to develop legislation on tax reform, it is altogether appropriate to examine the tax burden borne by some high income taxpayers relative to others. Similarly, it is appropriate to examine partnership activities since they are often seen as vehicles for tax shelters.

With any analysis of high income taxpayers and partnerships, a natural reaction is to focus on the negative aspects--on the high income individuals who pay little or no tax, and on the growth in partnerships with losses. While these represent important parts of the picture, it is also important to keep in mind the positive aspects--that most high income families do pay a fair share of taxes, and that most partnerships are profitable. Unlike corporations, partnerships "flow through" their income and expenses to be taxed at the partners' level, and therefore are conducive to tax shelters. The partnership form of organization does, however, serve some very important business purposes in allowing individuals or other enterprises to conduct business together or to invest together. Partnerships are not the only vehicle by which investors can receive preferential tax treatment--sole proprietorships and small business corporations, in different ways, can also be used for tax shelters.

But neither the business entity used for tax shelters nor the high income individuals who participate in them are responsible for the unfairness in our tax system and the prominence of tax shelter activity. Rather, the problems arise from high marginal tax rates and the ability of taxpayers to reduce those rates by investing in activities that are given preferential treatment in our existing tax code. Thus, in many instances, those tax provisions which are intended to encourage certain kinds of economic activity are also those that cause the perception that the system is unfair.

My testimony is divided into three parts. First, I will discuss high income taxpayers, drawing from and expanding on the report we sent to this Subcommittee on July 31. Next, I will describe the growth in partnership activity over the last two decades. Finally, I will discuss our detailed analyses of the most recent data available from partnership tax returns as contained in the partnership report which we sent to you yesterday. For the conveyance of the Subcommittee, I have appended copies of both of these reports to this testimony.

I. High-Income Taxpayers

To analyze the tax returns of high income individuals, it is necessary to measure income before any deductions or offsets are taken. The measure we used in our analyses is "total positive income," referred to as TPI. The main components of TPI are (1) wages and salaries, (2) interest, (3) dividends, and (4) income from profitable businesses and investments. The calculation of total positive income does not permit the otherwise allowable deduction for 60 percent of long-term capital gains, nor does it permit income to be reduced by various exclusions and deductions, such as IRA and Keogh contributions, and many business and investment losses.

For analyzing the tax returns of high income individuals, TPI allows us to identify both "above-the-line" and "below-the-line" reductions in taxable income. "Below-the-line" offsets reflect itemized deductions and tax credits. "Above-the-line" offsets include certain business and investment losses, exclusions, and "adjustments to income." Many reported losses represent real economic losses, but many of them also reflect the use of tax preferences or tax incentives that generate losses for tax purposes and create opportunities for tax shelters. "Above-the-line" offsets represent the difference between all positive amounts of income and adjusted gross income.

In its annual reports on high-income individual returns, the Internal Revenue Service uses four income concepts, ranging from adjusted gross income (AGI) to expanded income. Expanded income differs from AGI in that it includes certain tax preference items, such as those identified by the current minimum tax, and excludes excess investment expenses. These measures are useful in indicating the degree to which itemized deductions or tax credits ("below-the-line" adjustments) reduce tax liability. Not even expanded income, however, can shed much light on the extent to which "above-the-line" losses enable taxpayers with substantial economic income to reduce AGI and therefore taxable income and tax liability.

For analyzing high income tax returns, TPI is a more useful measure of income than is AGI or any of the related concepts. Like all measures, TPI is not perfect, however. There are no taxpayer data on the ideal measure of income that economists frequently call "economic income." In theory, economic income counts income from all sources, whether or not it is reported on the tax return, and accurately measures each form of income. Such an ideal measure would separate economic losses from losses claimed on tax returns. In practice, however, economic income is difficult to measure and cannot be constructed using only data from tax returns. For some taxpayers, TPI may overstate economic income by excluding some real economic losses and by making no inflation adjustment to reported capital gains. For other tax returns, TPI would tend to understate economic income to the extent that losses for tax purposes offset economic gains within many profitable activities, and to the extent that accrued capital gains are not reported on tax returns.

For our purposes, we chose a high cutoff level of $250,000 of TPI for considering any return "high income." We performed a computer examination of all 260,275 individual returns for 1983 with TPI in excess of $250,000. These returns represented about one-quarter of one percent of all returns filed for 1983.

Analysis. The report that I submitted to the Subcommittee on July 31 describes most of the results of our analysis of the high TPI returns, but I would like to mention several of the findings and add a few points that were not reported there.

While much interest centers on high income taxpayers who pay little tax, it is important to remember that most of the taxpayers filing the returns we examined paid a substantial share of their income in taxes in 1983. Nearly half owed tax equal to at least 20 percent of their TPI; nearly one-quarter (23.6 percent) owed tax equal to at least 30 percent of their TPI; and 5 percent owed taxes of at least 40 percent of their TPI. (Table 1.)

On the other hand, a significant minority owed very low taxes in 1983 relative to their positive income. Eleven percent, or almost 30,000 high TPI individuals, paid less than 5 percent of TPI in tax. Of these, over 3,000 had TPI in excess of $1 million. In addition, 7,674, or 2.9 percent, of those filing returns with TPI over $250,000 owed zero tax. Of these, 931 had TPI of at least $1 million.

For the high TPI individuals who paid little or no tax, the logical question is, how did they do it? As Table 2 shows, "above-the-line" offsets to TPI were much more important than "below-the-line" offsets such as itemized deductions.

- In the aggregate, for high income taxpayers owing less than 5 percent of TPI in tax, itemized deductions offset only 18 percent of TPI, whereas losses and capital gains deductions actually exceeded TPI, offsetting 112 percent of TPI.

Also, among the above-the-line offsets, what we called "current business losses" were more important than the combination of the capital gains deduction and other losses (principally losses carried over from previous years).

- Current business losses offset 67 percent of TPI, compared to 46 percent for the capital gains deduction and loss carryover category.

Partnership losses dominated the category of current business losses for these high income, low tax individuals. Partnership losses represented 36 percent of TPI and accounted for over one-half the current business loss offset to TPI. The other forms of current business loss--principally losses from farming activities, sole proprietorships, rental properties, and small business corporations--each registered only about 7 to 8 percent of TPI. Partnership losses were also the most common form of current business loss among the high income, low tax returns: 23,000 returns, or 77 percent, reported some partnership loss.

High-income taxpayers as a group, including those paying significant taxes, made substantial use of above-the-line offsets, though less than the high income individuals with low tax liabilities. Above-the-line losses and exclusions offset 41 percent of TPI for high income taxpayers as a whole in 1983.

- o Capital gains deductions and loss carryovers accounted for the majority of these offsets -- 23 of these 41 percentage points, with current business losses the remaining 18 percentage points.

- o Within the category of current business losses, partnership losses again dominated, equalling 11 percent of TPI, or one-quarter of all above-the-line offsets for all high income returns.

Partnership losses are clearly a major, though not the only, source of reduction in taxable income, and therefore in taxes paid, for high income taxpayers.

High income taxpayers also report a disproportionately large share of all the partnership losses that appear on individual income tax returns. (Table 3.)

- o 166,401, or 64 percent, of all high income taxpayers registered some partnership loss in 1983. Only 2 percent of all taxpayers reported partnership losses.

- o The aggregate amount of partnership losses reported on the returns of high TPI individuals totaled $17.6 billion, 52 percent of the $34.2 billion in partnership losses reported on all individual tax returns in 1983. For comparison, these high income taxpayers generated less than 10 percent of all TPI in 1983.

- o Whereas partnership gains reported on all individual tax returns exceeded partnership losses by $900 million in 1983, among high income returns the losses exceeded gains by $6.5 billion.

Again, it must be emphasized, however, that the TPI measure does not distinguish between economic losses and losses that appear only for tax purposes. Some portion of these partnership losses thus represent real economic losses that properly reduced the taxable income shown on the returns examined. From our data, the real economic losses that result from bad luck, misjudgments, or other business errors cannot be distinguished from losses advertised by tax shelter promoters. We know that total positive income includes some real losses, but also that the other frequently used measure, adjusted gross income, excludes all tax shelter losses.

Available information can, however, help us to understand better the sources of losses. Since our analysis has identified partnerships as the main source of business losses for high income taxpayers, and since there is much interest in partnerships as a common vehicle for tax shelters, the rest of my testimony will focus on the partnership sector.

II. Historical Data on Partnerships

Historically, the partnership sector has been the source of substantial taxable income for individuals and for taxpayers as a whole, as Table 4 shows. In the mid-1960s partnerships generated net income of around $10 billion annually, most of which appeared on individual's tax returns. During the 1970s, the gains and losses generated by partnerships grew substantially, although the net income for the sector as a whole and the net amounts reported on individual returns did not show similar growth until the latter part of the decade.

The pattern of fairly stable or generally rising net income from partnerships changed abruptly in 1980. Between 1979 and 1980, net income for the sector dropped from $15.2 billion to $8.2 billion, and losses from loss partnerships jumped from $24.8 billion to $36.8 billion. In 1981, partnerships in the aggregate reported a net loss for the first time in the 25 years that annual statisics on partnership returns have been available. The net losses in the partnership sector have continued through 1983, the most recent year for which statistics are available, with 1982 showing the greatest net loss of the three years. Losses have assumed a greater prominence in the last three years for which statistics are available than at any time in the nearly three decades of statistics on partnerships. In 1981 and 1982, but not in 1983, individual taxpayers overall also reported small net losses from partnerships on their returns. In a few moments I will turn to a more detailed analysis of the partnership sector in these recent years.

Generally, over the past two decades, growth within the partnership sector has been concentrated in certain industries and types of partnerships, as our July 31 report to the Subcommittee documented. (Table 5)

- Between 1965 and 1983, the number of partnerships in both real estate and finance more than tripled, and oil and gas partnerships more than quadrupled. Meanwhile, the total number of partnerships in other industries increased by only 15 percent.

- Between 1965 and 1983, the number of partnerships reporting losses more than tripled, from 229 thousand to 757 thousand. Particularly rapid growth in the number of partnerships with losses appeared in the oil and gas, and real estate industries.

- Although limited partnerships represented only 1 in 12 of all partnerships in 1977, they accounted for one-third of the increase in the number of partnerships between 1977 and 1983. Only one-quarter of all partners in 1977 belonged to limited partnerships, but 88 percent

of the increase in partners over the next six years was attributable to limited partnerships. General partnerships experienced little growth during this period.

III. Partnership Losses, 1981-1983

I would now like to take a closer look at the characteristics of those partnerships that reported losses in the last few years and the sources of those losses.

Measure of Income. Partnerships do not pay taxes themselves. Rather, a partnership is an entity that passes through income and expenses to its partners. Generally, these items are taxed as if received or incurred by the partners, although special rules and limitations apply to some of those items. Consequently, what a partnership usually reports as partnership income is not what most people would really consider income from a partnership. Therefore, we made some adjustments to the measure of net income that partnerships report on Form 1065. We refer to this measure of income from which we start as 1065 net income. (Line 5, Table 6.)

We wanted to arrive at a concept that would reflect the contribution that partnership activities make to taxable income reported by the separate partners. Some of the adjustments we made involved items of income or expense which are subject to special treatment at the partner level, such as investment interest expenses and long-term capital gains. A few adjustments required estimates of items that are not fully reported on any of the partnership tax forms. Most of the mineral exploration costs fell into this category. Income after these adjustments is called "contribution to partner's taxable income." Table 6 shows the steps required to go from 1065 net income to "contribution to partner's taxable income after ITC. (Line 17) The report, Analysis of Partnership Activity, which I submitted to the Subcommittee yesterday and which accompanies my testimony, describes the adjustments in more detail.

Our final measure of income is not perfect. There remain other items of income and expense which receive special treatment at the partner level and which were not available in the Statistics of Income data. Compared to 1065 net income, however, "contribution to partners' taxable income" provides a better reflection of the income arising from partnership activity being reported for tax purposes.

The overall effect of the adjustments on net income was fairly small. In 1983, 1065 net income for all partnerships was a loss of $2.6 billion, whereas we estimate the contribution to partner's taxable income after ITC as a loss of $0.9 billion. The coincidental closeness of the -$2.6 and -$0.9 hides an increase in the gain reported by gain partnerships and a nearly offsetting increase in the losses reported by loss partnerships.

Analysis. I will now turn to the discussion that you requested of the characteristics of partnerships with losses and the sources of those losses.

From our examination of the IRS Statistics of Income computer files of partnerships for the years 1981 through 1983, partnerships with losses are more likely to exhibit certain characteristics than partnerships with gains.

(1) Limited partnerships. A higher percentage of limited partnerships than of general partnerships register losses. Limited partnerships are owned in part by "limited partners," passive investors whose liability for partnership debts is limited to amounts they agree to contribute. Limited partners, like partners with full liability for partnership debts, may report their shares of partnership gains and losses on their individual tax returns. In 1983, 65 percent of limited partnerships reported losses, compared to 46 percent of general partnerships. Table 6 also indicates that based on 1065 net income in each year, from 1981 to 1983, limited partnerships in the aggregate produced net losses, whereas general partnerships generated gains. In 1983, 51 percent of all the losses and only 14 percent of the gains in contributions to partners' taxable income came from limited partnerships.

(2) Recent formation. Not surprisingly, recently formed partnerships are more apt to register losses than are older partnerships (Table 7). This is true for both limited and general partnerships, although limited partnerships are consistently more likely to have losses than are general partnerships formed during the same period. In 1983, 51 percent of all partnerships started between 1981 and 1983 generated negative income, compared to only 32 percent of partnerships formed before 1978. And the percentage showing losses declines steadily as the age of the partnership increases. In part, the explanation for this is that recently formed businesses incur startup costs that are not immediately covered by revenues. Furthermore, many tax provisions "front-load" deductions in the early years.

(3) High debt-equity ratios. Loss partnerships in general have higher debt-equity ratios than partnerships showing net gains. Table 8 shows that the average debt-equity ratio for all partnerships in 1983 was 5.25; for partnerships with losses the same ratio was 13.67. A similar correlation appears within most of the industries detailed in Table 8. Some caution should be used in interpreting the debt-equity ratios, however, because partnership equity is generally understated, particularly for older partnerships, because assets are valued at book value. The correlation still holds, though, for partnerships formed in 1983; gain partnerships had a debt-equity ratio of 1.78, compared to 4.89 for loss partnerships.

(4) Industry. Losses are not evenly distributed across industries, as Table 8 indicates. This table provides details on all broad categories of industries and on individual industries with over $100 million in net losses in 1983. As might be expected, industries with losses generally had a higher than average proportion of individual partnerships reporting losses. In some industries, almost all partnerships report losses. In livestock breeding 93 percent report losses, in metal mining 97 percent, in racing 88 percent, and in water transportation 80 percent report losses.

Sources of Partnership Losses. There is a general interest in knowing the extent to which various tax code provisions contribute to partnership losses. Most interest focuses on provisions offering special tax treatment. Unfortunately, the available data do not permit us to determine precisely the role of various tax preferences in generating the tax losses that emerge from the partnership sector. Although we know which provisions afford economic incentives to certain activities by understating income or overstating expenses, compared to the economically correct amounts, we cannot identify their effect on individual partnerships

For example, because the current law depreciation schedules have been designed to encourage investment, we know that much of the depreciation deductions reported for tax purposes exceed the economic depreciation of the underlying assets. However, by focusing on the tax return data which provide no further information on actual economic income we cannot determine how much of the depreciation deductions reported on the tax return exceed an economic allowance for depreciation for the specific partnership. We would need to know the years in which the various assets were purchased and the method of depreciation used, information that is not available on the computerized data files. Similarly, interest expense deductions overstate the economic cost of debt because, with inflation, the real value of the debt is declining. Without knowing the interest rate being paid, we cannot separate the inflation component from the real component of interest payments.

The data we have available on partnerships do, however, allow us to identify the total amount of income and deductions in various categories reported in 1983 by all partnerships and by partnerships in particular industries. Table 9 reports the major categories of income and expenses for the partnership sector as a whole, and separately for each detailed industry that reported at least $100 million in losses in 1983.

The table shows several points.

(1) For the partnership sector as a whole, three categories of deductions--interest, depreciation, and mineral exploration costs--accounted for over 40 percent of all deductions--which

include wages and salaries, rent, repairs, and taxes--reported on the partnerships' tax forms in 1983. In many industries this percentage was much higher. In oil and gas, extraction costs alone nearly equaled the category of "other deductions." In real estate, interest deductions were the major expense; interest and depreciation exceeded "other deductions" by $5 billion. For real estate subdividers and developers, and for holding companies, interest expenses alone exceed "other deductions". In equipment rental and leasing, depreciation deductions and interest expenses each alone exceeded "other" expenses. In water transportation, depreciation deductions also were greater than "other" deductions.

(2) For the sheer magnitude of losses, real estate operators and lessors of buildings dominate all other industries. Although their gross ordinary income is only one-third of the total for all partnerships, they account for one-half the depreciation deductions and 55 percent of the interest expenses. The next largest amount of interest and depreciation deductions is reported in the equipment rental and leasing industry. That sector accounts for less than two percent of the total gross ordinary income for all partnerships, but over seven percent of all depreciation deductions. Oil and gas closely follow equipment leasing in size of interest and depreciation deductions.

(3) Long-term capital gains represent an important source of income for partnerships in several industries, notably real estate, holding companies, and agriculture. To the extent that a partnership is able to defer its income and receive it in the form of long-term capital gains which give rise to a 60 percent deduction against partners' taxable income, the partnership could in fact be generating a profit even if it were registering losses for tax purposes.

(4) The investment tax credit (ITC) also affects our final measure of income for partnerships as a whole. In 1983, partnerships reported $1.7 billion in ITC. Every dollar of credit offsets the tax on approximately $4 of the income of individual partners. Thus, without the credit, the contribution of partnerships to partners' income would have been a gain of $5.2 billion. However, there are few industries shown on Table 9 in which the ITC is large, relative to the net income figure. Only for agriculture, all transportation, manufacturing, holding companies, and motion picture partnerships does the ITC offset 10 percent or more of the contribution to partners' taxable income.

Conclusion

Our analysis of high income tax returns has shown that in 1983, many high income individuals paid taxes equal to a substantial portion of their total positive income, but a significant minority paid virtually no tax. For the high income

individuals with low tax liabilities, partnership losses were a major source of reduction in taxable income. Moreover, partnership losses and partnerships with losses have been increasing fairly consistently in the past two decades.

Neither these data nor these trends should be considered an indictment of partnerships or high-income individuals. High marginal tax rates give high income taxpayers the incentive to seek to lower their taxes by investing in activities that offer preferential tax treatment. Unlike corporations, partnerships flow through income and expenses to the owners. A partnership is, therefore, a vehicle particularly conducive to spreading the tax preferences of particular investments to investors, which in some cases produces tax shelters. We therefore suggest that, as the tax reform debate proceeds, the Subcommittee should focus on the appropriateness of continuing the current law tax provisions that afford preferential treatment of certain activities and on high marginal tax rates that encourage high-income individuals to seek these activities.

Table 1

1983 Returns with Total Positive Income* of $250,000 or More

	TPI Over $250,000	Percent of Total
All Returns	260,275	100%
Returns With Taxes Paid as Percent of TPI:		
Zero	7,674	2.9
Zero to 5%	22,126	8.5
5 - 10%	25,452	9.8
10 - 20%	83,173	32.0
20 - 30%	60,393	18.8
30 - 40%	49,021	4.8
Over 40%	12,436	
Returns With:		
Partnership Losses	166,401	63.9
Partnership Losses Exceed 50% of TPI	12,655	4.9
Partnership Losses Exceed TPI	1,916	0.7

Office of the Secretary of the Treasury
Office of Tax Analysis

September 18, 1985

* Total Positive Income (TPI) measures gross income reported on tax returns before losses. It primarily equals the sum of positive amounts of income on the Form 1040, with the following exceptions: For capital gains, it equals long- and short-term gains before losses and before exclusions. For Schedule E, TPI includes the income on rental and royalty properties with profits, on partnerships, on estates and trusts, and on small business corporations with gain. TPI does not subtract various exclusions or deductions which reduce AGI, such as IRA and Keogh contributions, and the 60 percent exclusion of long-term capital gains.

Source: Extract from the 1983 IRS Individual Master File of all tax returns with TPI of at least $250,000.

Table 2

Offsets to Total Positive Income for High Income Taxpayers, 1983

	"Above-the-Line" Offsets to TPI				"Below-the-Line" Offsets to TPI		
	Partnership Losses	Other Current Business Losses	All Other Losses & Capital Gains Exclusions	Total Losses & Capital Gains Exclusions	Excess Itemized Deductions	Credits ITC & FTC	Tax After Credits
	(Percentage of TPI)						
All High TPI Returns	10.9	7.4	23.2	41.5	13.6	0.8	20.2
Tax Under 5% TPI	36.2	31.0	45.7	112.8	17.8	1.0	1.7
Tax Over 20% TPI	3.6	2.2	10.7	16.5	11.6	0.5	30.6

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* Current Business Losses include losses on partnerships; net losses from Schedule C, Subchapter S corporations, rental and royalty properties, and farms; and net supplemental losses.

** "All Other Losses and Capital Gains Exclusions" are primarily the excluded portion of capital gains plus substantial loss carryovers.

Source: Extract from the 1983 IRS Individual Master File of all tax returns with Total Positive Income of at least $250,000.

Note: For a definition of TPI, see Table 1.

Table 3

Partnership Losses and Gains Reported on Individual Income Tax Returns, 1983

	All Taxpayers	All High TPI Returns
ll Returns	96,321,000	260,275
eturns with Partnership Loss	2,030,000	166,401
Percent of Total	2.1%	63.9%
Amount of Partnership Loss (in billions)	$34.2	$17.6
eturns with Part... ship G... s	2,093,000	131,270
Percent of Total	2.2%	51%
Amount of Partnership Gains (in billions)	$35.1	$11.1

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September 18, 1985

ources: Extract from the 1983 IRS Individual Master File of all tax returns with TPI of at least $250,000; and the Statistics of Income Individual Income Tax File for 1983.

ote: For a definition of TPI, see Table 1. "High TPI" indicates returns with TPI of at least $250,000.

Table 4

Partnership Income and Loss, 1965-1983

	Income or Loss of Partnership			Partnership Income Reported on Individual Returns			Limited Partnerships		
	Net Income or Deficit	Gain Partnerships	Loss Partnerships	Net Income or Deficit	Net Gains	Net Losses	Percent of All Partnerships	Net Income	Number of Partners
	($ in Billions)								
1983	$-2.6	$60.3	$62.9	$0.9	$35.1	$34.2	15.2%	$-18.7	5,434,870
1982	-7.3	53.6	60.9	-0.9	27.4	28.3	14.9	-17.5	4,709,723
1981	-2.7	50.6	53.3	-0.1	27.9	26.0	14.3	-15.7	4,176,572
1980	8.2	46.0	36.8	9.4	25.6	16.2	12.3	-9.4	3,620,036
1979	15.2	40.0	24.8	12.4	24.2	11.8	10.5	-5.7	2,352,378
1978	14.4	33.7	19.2	15.1	24.3	9.2	9.6	NA	NA
1977	13.3	28.9	15.7	13.4	21.4	8.0	8.3	-3.6	1,542,107
1976	10.4	24.9	14.5	11.7	19.7	8.0			
1975	7.7	22.4	14.7	10.8	18.4	7.6			
1974	8.9	21.6	12.7	11.0	17.9	6.9			
1973	9.2	18.9	9.7	11.2	16.8	5.6			
1972	9.6	17.0	7.3	11.1	15.3	4.2			
1971	9.1	15.5	6.4	10.8	14.2	3.4			
1970	9.8	14.4	4.6	10.9	13.7	2.8			
1969	10.5	14.0	3.5	11.9	14.2	2.3			
1968	11.4	13.6	2.2	13.5	15.7	2.2			
1967	10.8	12.8	1.9	11.5	13.0	1.5			
1966	10.4	12.1	1.7	10.7	12.1	1.4			
1965	9.7	11.3	1.6	9.8	11.1	1.3 1/			

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1/ Includes small business capital net gain or loss.

Source: IRS, Statistics of Income, Partnership Returns and Individual Income Tax Returns for relevant years.

Table 5

Partnership Activity, by Selected Industry for Selected Years, 1965-1983

	1965	1970	1975	1980	1983
Total Losses Reported on Partnership Returns (Billions)					
All Industries	$1.6	$4.6	$14.7	$36.8	$62.9
Oil and Gas Drilling	.1	.5	1.7	7.3	9.5
Real Estate	.6	2.1	6.5	11.4	29.5
Agriculture	.2	.4	1.1	2.1	2.8
Finance	.1	.7	1.8	8.0	5.8
Services	.2	.4	1.9	3.2	8.1
Number of Partnerships, With and Without Net Income					
All Industries	914,215	936,133	1,073,094	1,379,654	1,541,539
Oil and Gas Drilling	12,467	11,820	12,974	31,405	56,172
Real Estate	192,833	235,443	320,878	464,389	585,481
Agriculture	127,782	124,165	123,173	126,224	136,603
Finance	44,537	75,720	106,595	165,969	135,815
Services	168,850	175,800	198,956	263,400	306,294
Percent of Partnerships Without Net Income					
All Industries	25.1%	31.2%	38.4%	43.9%	49.1%
Oil and Gas Drilling	44.5	37.4	44.4	54.5	58.8
Real Estate	38.5	42.3	49.5	54.5	58.2
Agriculture	27.7	32.1	39.8	42.7	46.2
Finance	34.4	46.8	45.3	42.6	44.6
Services	18.4	24.2	30.4	35.7	38.7
Number of Partners					
All Industries	2,721,899	3,697,818	4,950,634	8,419,899	10,589,338
Oil and Gas Drilling	NA	175,744	213,238	686,431	1,987,935
Real Estate	674,489	1,016,791	1,549,716	3,212,213	4,327,771
Agriculture	322,147	318,611	351,062	380,982	466,132
Finance	317,187	929,328	1,422,954	2,329,161	1,572,901
Services	448,558	525,[illegible]	668,858	938,027	1,274,934
Percent of Partners in Partnership Without Net Income					
All Industries	28.8%	35.6%	43.0%	42.7%	49.0%
Oil and Gas Drilling	NA	46.2	34.5	44.4	38.6
Real Estate	41.0	44.2	58.0	50.6	60.3
Agriculture	28.1	34.1	45.4	46.1	48.6
Finance	38.1	40.3	38.2	34.2	31.5
Services	19.4	24.1	34.2	38.9	46.6

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Source: IRS, *Statistics of Income, Partnership Returns*, relevant years.

Table 6. Growth in Partnership Activity (Dollar amounts in billions)

	All partnerships			Limited partnerships			General partnerships		
	1981	1982	1983	1981	1982	1983	1981	1982	1983
Number of partnerships	1460502	1514212	1541539	208204	225886	233986	1252298	1288326	1307553
Number of partners 1/	9095165	9764667	10589338	4176572	4709723	5434870	4918593	5054944	5154468
Total partnership assets	715.2	845.3	887	282.4	331.7	381.4	432.8	513.6	505.6
Gross receipts and gross rent	281.6	312.2	313.5	55.7	70.3	70.9	225.9	241.9	242.6
Form 1065 income or loss	-2.7	-7.3	-2.6	-15.7	-17.5	-18.7	13	10.2	16.1
Less income from other partnerships, plus dry hole costs, non-oil and gas depletion, and guaranteed payments to partners	14	15.4	14	5.8	5.8	5.5	8.2	9.6	8.5
Adjusted Form 1065 income or loss	11.3	8.1	11.4	-9.9	-11.7	-13.2	21.2	19.8	24.6
Items not reported on Form 1065:									
Plus foreign income	1.4	1.4	1.4	.1	.1	.1	1.3	1.3	1.3
Less mineral exploration costs	-12.7	-10.3	-8	-5.9	-4.6	-4.1	-6.8	-5.7	-4
Less investment interest expense	-4.9	-5.8	-5.1	-1.9	-2.2	-2.7	-3	-3.6	-2.4
Less Sec. 1231 and spec. alloc. loss	-.9	-.9	-.9	-.3	-.3	-.3	-.6	-.6	-.6
Net ordinary income or loss	-5.8	-7.5	-1.1	-17.9	-18.7	-20.1	12.1	11.2	19
Capital gains	5.5	7.1	8.8	1.7	2.2	2.2	3.8	4.9	6.6
Sec. 1231 or spec. alloc. gains			7.1			3.5			3.6
Contribution to partner's taxable income before ITC 2/			5.2			-17.8			23
Investment tax credit	1.5	.1	1.7	.5	.7	.8	1	-.6	.9
Contribution to partner's taxable income after ITC 3/			-.9			-20.6			19.6
Percent of partnerships with positive total ordinary income	45.1	52.3	50.9	18.9	38.1	34.6	48.6	54.7	53.8

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1/ Includes partners that are corporations and partnerships, as well as indivduals.

2/ Contribution to partner's taxable income before ITC equals ordinary income plus 40% of total capital and Sec. 1231 gains.

3/ Contribution to partner's taxable income after ITC equals ordinary income plus 40% of total capital and Sec. 1231 gains less the investment tax credit divided by an average marginal tax rate.

Table 7

Characteristics of Partnerships in 1983 by Year Partnership Formed

	Year Partnership Started				
	1983	1981-82	1978-80	1973-77	Before 1973
Percent of all Partnerships with Positive Net Income:	26.9	40.2	49.0	62.9	71.6
Percent of Limited Partnerships with Positive Net Income:	11.4	20.1	36.4	56.3	64.8
Percent of General Partnerships with Positive Net Income:	30.3	44.4	51.6	64.1	72.3
Limited Partnerships					
As Percent of Total Partnerships	18	17.2	16.9	15.6	8.8
As Percent of Total Partners	65.6	60.3	53.9	46.7	23.9
Debt/Equity Ratios:					
Partnerships with Positive Income	1.78	1.78	2.58	4.43	1.64
Partnerships without Positive Income	4.89	9.10	40.07	*	*

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Source: 1983 Statistics of Income Partnership file.

* Indicates negative equity in these years.

Table 8. Summary of 1983 Partnership Characteristics by Industry and Type of Partnership.

	Number of Partnerships	Percent Partnership	Percent Limited Partnerships	Percent Formed In 1981-83			Ratio of Debt to Equity		
				All	Loss	Limited	All	Loss	Limited
All	1541538	49.14	15.18	38.61	50.94	44.6	5.25	13.67	9.5
All Agriculture	136603	46.23	6.73	24.78	37.1	39.4	4.06	11.57	2
Fruit Trees	12091	52.88	20.35	21.14	38.99	62.2	3.64	21.05	5.4
Beef,ex.feedlots	18852	66.79	2.17	11.09	15.01	9.8	5.44	*	1.4
Livestock breeding	2269	92.7	27.89	85.15	91.16	76.2	2.01	2.01	2.1
All Mining	59535	59.63	39.3	52.02	61.32	52.7	.77	1.04	1.2
Metal	1793	97.17	84.16	30.03	30.79	32.5	.88	.99	.5
Coal	552	68.3	33.16	32.15	43.56	8.9	2.31	2.39	*
Oil and gas	56172	58.83	37.23	53.82	63.81	56.6	.69	.94	.9
Construction	63592	28.11	2.5	49.24	54.36	77.4	3.67	14.18	*
All Manufacturing	26451	52.84	2.97	45.97	46	57.8	2.3	3.78	12.7
Lumber	4389	30.9	.52	6.1	12.24	25.9	2.07	2.91	5.2
Chemicals	308	63.9	55.73	70.07	86.79	94.2	1.38	1.74	1.8
All Transportation	20132	55.24	11.91	52.38	57.37	74.3	1.38	1.38	4.2
Water	654	80.43	44.53	43.36	48.9	16.5	46.38	80.75	15.9
Communications	3530	64.03	12.72	64.02	48.22	67.3	4.51	6.4	4.4
Electric	1385	80.56	4.86	9.34	10.6	83.3	.37	.31	1.3
Wholesale Trade	24115	35.55	5.49	47.19	63.63	10.4	2.78	10.24	4.9
Retail Trade	168153	49.06	3.67	43.81	55.56	31.2	1.59	4.59	1.6
All finance	730067	55.19	22.38	33.57	46.96	41.6	7.68	32.56	12.8
Real Estate	491701	58.65	22.27	34.9	49.56	44.9	19.22	125.29	57.9
Subdividers	42670	62.33	26.44	41.7	44.82	39.9	7.87	20.63	11
Holding companies	108755	42.31	26.45	20.72	29.87	28.8	1.98	4.25	1.5
All services	306294	38.68	8.34	46.45	63.98	57.9	7.11	*	103.1
Hotels	3074	69.25	32.34	45.84	62.7	45.4	26.59	*	*
Motels	7398	42.86	19.33	28.22	58.13	48.1	18.26	*	*
Equipment leasing	36335	47.74	12.92	46.06	65.15	68.2	*	*	*
Motion pictures	4382	60.79	40.91	41.45	56.29	5.8	4.89	5.38	*
Racing	3948	87.63	.2	50.35	57.45	74.5	.67	.7	1.4
Other Amusement	7528	75.55	9.02	59.5	61.67	28.7	13.84	*	247.7

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Source: IRS Statistics of Income, Partnership Returns, '83.

* Indicates negative equity.

Table 9. Summary of 1983 Partnership Income and Deductions by Industry (in Millions of Dollars)

	Gross Ordinary Income 1/	Deductions Other Than Deprec., Interest, Min.Exp. Costs 2/	Interest	Deprecia-tion	Estimated Mineral Explor-tion Costs 3/	Net Ordinary Income	Capital Gain	Investment Tax Credit	Contri-bution to Taxable Income (After ITC)
All	213517.7	126102.9	48215.4	32285.5	8045.5	-1131.6	15942	1713.8	-947.3
All Agric.	3396.8	2216.6	474.1	457.8		248.3	746.4	105.9	157.5
Fruit Trees	-84.9	106.5	42	35		-268.4	51.4	21.2	-323.7
Beef,ex.feedlots	57.7	202	65.5	47.8		-257.6	171.2	13.9	-237.9
Livestock	-21.4	61.2	7.7	47.1		-137.4	18.1	7	-154.2
All Mining	12996.2	10089.9	1394.7	2563.2	7887.1	-8938.7	274	163.2	-9435.4
Metal	558	452.2	122.4	228.8	90.3	-335.7	20.9	9.9	-362.5
Coal	763.1	584	118.2	147.5	108.8	-195.4	20.8	2.5	-196.9
Oil	11404	8889.7	1114.1	2127.9	7656.8	-8384.5	227.6	141.6	-8820.2
Construction	6688.9	3194.9	553.7	480.1		2460.2	178.4	12.6	2483.4
All Manufacturing	3332	2857.6	403.6	727.8		-657	113.9	128.2	-1065.4
Lumber	449.5	314.9	99.4	128.5		-93.3	66	22.4	-145.4
Chemicals	189.6	469.7	94.6	184.9		-559.6	6.2	19.1	-626.6
All Transportation	5005.7	2918.8	855.9	1292.6		-61.6	46	128.2	-474.2
Water	406.7	178.9	169.3	206.6		-148.1	.2	.9	-151.8
Communication	1114.1	984.2	234	339.1		-443.2	.2	40.1	-600.3
Electric	346.7	456.9	161	237.5		-508.7	4.1	39.6	-653.8
Wholesale Trade	3034.8	2019.8	325.2	221.2		468.6	54.4	6.4	465.7
Retail Trade	13011.7	9937.6	550.2	763.4		1760.5	84.2	1.9	1655.9
All finance	96918.9	50764.5	38830	18910.1	83.2	-11668.9	13833.7	653.8	-8460
Real Estate	68994.1	38237.9	26777.7	16780.7		-12802.2	6987.7	8.9	-11534.8
Subdividers	4991.7	2754.8	2827.3	486.5		-1076.9	409.9	44.3	-1069.9
Holding companies 4/	7081.6	3179.7	3483	968.6	409.9	-959.6	3985.9	103.7	265.2
All services	68824.9	41983.2	4814	6848.4		15179.3	609.9	488	13631.5
Hotels	4233.3	3336.2	988.7	763.7		-855.3	108.5	67.4	-1048.2
Motels	3511.4	2366.6	691.6	572.8		-119.6	53.8	20.8	-173.6
Equipment leasing	4038.2	1287	1316.1	2305.2		-870.1	18.8	130.9	-1329.2
Motion pictures	1113.5	852.4	70.8	396		-205.7	23.2	90.2	-527.2
Racing	41.5	122	3.9	70.8		-155.2	.6	1	-158.4
Other Amusement	1845.2	1415.8	217.2	389		-176.8	21.1	27.5	-267.6

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1/ Net of cost of goods sold and net income from other partnerships.

2/ Excludes guaranteed payments to partners.

3/ Includes estimated depletion, hard mineral exploration and development costs, and intangible drilling costs (including dry hole costs).

4/ Includes income and expenses from other partnerships.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

TAXES PAID BY HIGH-INCOME TAXPAYERS AND THE GROWTH OF PARTNERSHIPS

Whether a tax system is judged to be fair depends, in part, on whether those citizens who are most able to pay taxes are perceived to pay a fair share of their income in taxes. Earlier analyses have focused on the extent to which taxpayers with high adjusted gross income (AGI) pay little or no tax. Such analyses are useful primarily in indicating the extent to which extraordinary itemized ("below-the-line") deductions reduce tax liability of high-income taxpayers. But they do not shed much light on the extent to which taxpayers with substantial economic income are able to reduce AGI, and therefore taxable income and tax liability, with various "above-the-line" losses, including losses from tax shelters.

A computer analysis of all income tax returns for 1983 filed by high-income individuals provides further information on the tax burden borne by high-income taxpayers and on the commonly used means of lowering that burden. The analysis clearly identifies partnership losses as a primary source of offset to other income and thereby of reduction in tax liability for these high-income persons. Although the study does not measure the amount of tax reduction attributable to the specific tax incentives that provide opportunities for tax shelters, recent trends in the partnership sector suggest the growth and prevalence of tax shelter activity.

I. Definition of Income

It has long been recognized that losses allowed for tax purposes are often not real economic losses; frequently they are merely accounting losses that result from tax shelter activities. Because tax losses can offset normally taxable income, it is necessary in analyzing taxes paid by high-income groups to use a measure of income which is relatively unaffected by accounting losses that may not be real.

The measure of income chosen for this purpose is total positive income (TPI), which essentially equals the sum of (1) wages and salaries, (2) interest, (3) dividends, and (4) income from profitable businesses and investments. Unlike the more commonly used measure of adjusted gross income, TPI does not subtract various exclusions or deductions which reduce AGI, such as IRA and Keogh contributions and the

60 percent of long-term capital gains that is excluded from taxable income. TPI also excludes most business and investment losses which are taken into account in computing AGI.

Based on this definition of income, a return was classified as a high-income return if total positive income exceeded $250,000. Since TPI excludes real losses as well as tax-shelter losses, it tends to overstate economic income; on the other hand, it understates economic income to the extent that tax shelter losses offset economic gains within many activities. Nonetheless, most returns with more than $250,000 of positive income can reasonably be classified as "high income." In 1983, 260,000 tax returns (or one-quarter of one percent of all returns) reported TPI in excess of $250,000; nearly 28,000 tax returns reported TPI in excess of $1 million.

II. Taxes Paid

Many taxpayers with high positive incomes paid a substantial share of their income in taxes in 1983; nearly half (47 percent) owed at least 20 percent of their TPI in tax.

A significant minority, however, owed very low taxes, in spite of the current law minimum tax. (See Table 1.)

- Almost 30,000, or 11 percent, of returns with TPI in excess of $250,000 paid virtually no tax; that is, taxes paid were less than 5 percent of TPI.

- Nearly twice as many owed no more than 10 percent of positive income in taxes. Fifty-five thousand, or 21 percent of all returns with positive incomes in excess of $250,000, paid 10 percent or less of positive income in taxes. Fifty-four hundred, or 19 percent, of returns with TPI over $1 million paid no more than 10 percent of positive income in taxes.

- Over 3,000, or 11 percent, of returns with TPI in excess of $1 million paid virtually no tax.

These high-income returns paying less than 5 or 10 percent of TPI in taxes are shouldering lower tax burdens than typical returns with substantially lower incomes.

- Upper-middle-income returns with TPI of between $30,000 and $75,000 paid on average about 13 percent of their positive income in taxes.

- Nearly 17,000 of the high-income returns with TPI exceeding $250,000 owed less than $6,272 in tax, the amount that a typical four-person family with $45,000 of income owed. Fifteen hundred returns with TPI in excess of $1 million owed less than this $6,272.

III. How Taxes Were Reduced

High-income returns with low tax liability relied most heavily on losses reported in current business activities, including those conducted in partnership form, to reduce their tax bills. (See Table 2.)

- Returns with TPI over $250,000 and taxes of less than 5 percent of TPI reported current business losses amounting, on average, to 67 percent of TPI. (Thus, for example, a typical high-income return showing TPI of $300,000 might show losses of $200,000 and AGI of $100,000; taxable income would be even less, after allowance for itemized deductions and personal exemptions.)

The capital gains exclusion and losses carried over from previous years also offset large amounts of positive income for the low-tax returns. Itemized deductions (such as for state and local taxes, mortgage interest expenses, and charitable contributions) were much less important in reducing taxes.

- For the high-income, low-tax returns--those with taxes less than 5 percent of TPI--the combination of the capital gains exclusion and losses other than on current business activities offset 46 percent of TPI. (The combination of this exclusion and these losses, together with current business losses, offset more than 100 percent of TPI, on average, for these returns.) Excess itemized deductions offset only 18 percent of TPI.

The high-income returns with relatively high tax liability--those with taxes exceeding 20 percent of positive income--seem to have more in common with the typical upper-middle-income return than with the high-income, low-tax return.

- "Above-the-line" offsets to TPI --primarily losses and the capital gains exclusion--were relatively unimportant for the high TPI returns with high taxes and for the upper-middle-income returns with TPI between $30,000 and $75,000. Current business

Table 1

1983 Returns with Total Positive Income* of $250,000 or More

	TPI Over $250,000	TPI Over $1 Million
All Returns	260,275	27,796
Returns with Taxes Paid as Percent of TPI:		
Less than 5%	29,800	3,170
5 - 10%	25,452	2,225
10 - 20%	83,173	11,307
Over 20%	121,850	11,094
Returns with:		
Partnership Losses	166,401	19,871
Partnership Losses Exceed 50% of TPI	12,655	1,600
Partnership Losses Exceed TPI	1,916	306

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* Total Positive Income (TPI) measures gross income reported on tax returns before losses. It primarily equals the sum of positive amounts of income on the Form 1040, with the following exceptions: For capital gains, it equals long- and short-term gains before losses and before exclusions. For Schedule E, TPI includes the income on rental and royalty properties with profits, on partnerships, on estates and trusts, and on small business corporations with gain. TPI does not subtract various exclusions or deductions which reduce AGI, such as IRA and Keogh contributions, and the 60 percent exclusion of long-term capital gains.

Source: Extract from the 1983 IRS Individual Master File of all tax returns with TPI of at least $250,000.

Table 2

Ways of Reducing Income Subject to Tax

	"Above-the-Line" Offsets to TPI			"Below-the-Line" Offsets to TPI		
	Current Business Losses*	All Other Losses & Cap. Gains Exclusions**	Total, Losses & Cap. Gains Exclusions	Excess Itemized Deductions	Credits: ITC & FTC	Tax After Credits
	(Percentage of TPI)					
All High TPI Returns	18.3	23.2	41.5	13.6	.8	20.2
Tax Under 5% TPI	67.2	45.7	112.8	17.8	1.0	1.7
Tax Over 20% TPI	5.8	10.7	16.5	11.6	.5	30.6
Upper-Middle-Income Returns***	4.4	6.1	10.5	9.9	.1	12.7

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* Current Business Losses include losses on partnerships; net losses from Schedule C, Subchapter S corporations, rental and royalty properties, and farms; and net supplemental losses.

** "All Other Losses and Capital Gains Exclusions" are primarily the excluded portion of capital gains plus substantial loss carryovers.

*** "Upper-Middle-Income Returns" have $30,000 to $75,000 of TPI.

Sources: Extract from the 1983 IRS Individual Master File of all tax returns with Total Positive Income of at least $250,000; and the Treasury Individual Income Tax Model for 1983.

losses averaged only 6 percent of TPI for the high-income, high-tax group and 4 percent of TPI for the moderate TPI returns. Capital gains exclusions and other losses offset an additional 11 percent and 6 percent of TPI for the two groups, respectively.

- For both the high-income, high-tax returns and for the upper-middle-income returns, itemized deductions--"below-the-line" offsets--were almost as important as all above-the-line offsets in reducing tax liability. Itemized deductions averaged 12 and 10 percent of TPI for the two groups, respectively.

For the high-income, low-tax returns, some of the current business losses that offset so much of positive income undoubtedly represent real economic losses. However, most of the losses came from partnerships. For some years, many partnerships have been utilized as vehicles for tax shelters (defined for purposes of this paper as activities producing net losses available to offset net income from other activities), and frequently they have registered accounting losses when they have incurred no real economic losses.

- Among the 30,000 taxpayers with TPI of $250,000 or more who paid virtually no tax (i.e. tax of less than 5 percent of TPI), partnership losses alone offset an average of 36 percent of total positive income.

- Eighty-eight hundred, or 30 percent of taxpayers with TPI greater than $250,000 and tax liability below 5 percent of TPI, reported partnership losses equal to at least half of their positive incomes.

- Approximately 1,900 high-income, low-tax returns had partnership losses which fully offset positive income.

IV. The Growth in Partnerships

The growth in tax shelter activity in recent years, particularly but not exclusively in limited partnerships, has been well advertised. Some figures help document that the growth in the partnership sector has been disproportionately concentrated in partnerships registering net tax

Table 3

Partnership Activity, 1965, 1975, and 1982

	1965	1975	1982
Partnership income reported by individuals (in billions): 1/			
Net Gain	$ 11.1	$ 18.4	$ 27.4
Net Loss	$ 1.3	$ 7.6	$ 28.3
Number of partnerships with and without net income 2/			
All industries	914,215	1,073,094	1,514,212
Oil and gas drilling	12,467	12,974	50,837
Real estate	192,833	320,878	562,575
Agriculture	127,782	123,173	132,394
Finance	44,537	106,595	147,676
Services	168,850	198,956	287,529
Number of partnerships with profits 2/			
All industries	684,822	661,134	791,117
Oil and gas drilling	6,934	7,214	21,686
Real estate	118,563	161,928	242,156
Agriculture	92,417	74,143	67,928
Finance	29,195	58,266	80,728
Services	137,774	138,510	180,153
Number of partnerships with losses 2/			
All industries	229,393	411,960	723,095
Oil and gas drilling	5,533	5,760	29,151
Real estate	74,270	158,950	320,419
Agriculture	35,365	49,030	64,466
Finance	15,342	48,329	66,948
Services	31,076	60,446	107,376
Total losses reported on partnership returns (in billions) 2/			
All industries	$ 1.6	$ 14.7	$ 60.9
Oil and gas drilling	.1	1.7	13.2
Real estate	.6	6.5	23.0
Agriculture	.2	1.1	3.1
Finance	.1	1.8	7.4
Services	.2	1.9	6.8
Numbers of partners 2/			
All industries	2,721,899	4,950,634	9,764,667
Oil and gas drilling	NA	213,238	1,512,328
Real estate	674,489	1,549,716	3,720,805
Agriculture	322,147	351,062	448,623
Finance	317,187	1,422,954	1,983,132
Services	448,558	668,858	1,171,642

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1/ Source: IRS Statistics of Income, Individual Income Tax Returns, Selected Years.

2/ Source: IRS Statistics of Income, Business and Partnership Tax Returns, Selected Years.

losses, in limited partnerships which are the form of business most commonly used to provide tax shelters, and in industries that are accorded favorable tax treatment such as the real estate and oil and gas industries. (See Table 3.)

Historically, the partnership sector has been the source of substantial net income for individuals. For many years, though, losses reported for tax purposes have been growing much faster than gains, and individuals have recently reported more partnership losses than gains.

- In 1965, individuals reported almost nine times as much income from partnerships as they did losses-- $11.1 billion in net profits vs. $1.3 billion in net losses. By 1975, the ratio of reported income to reported loss had declined to 2.4 to 1-- $18.4 billion vs. $7.6 billion. By 1982, though net partnership income had reached $27.4 billion, net losses had risen dramatically to $28.3 billion, actually exceeding net gains.

Growth in the partnership sector in recent years, much in the form of limited partnerships, has been concentrated in industries with favorable tax code treatment and therefore with opportunity for tax shelters.

- From 1965 to 1975, the total number of partnerships in all industries increased by a modest 17 percent, from some 914 thousand to almost 1.1 million. Between 1975 and 1982, formation of partnerships accelerated, with the total number of partnerships rising by 41 percent from almost 1.1 million to some 1.5 million.

- By comparison, from 1965 to 1975 the total number of partnerships in the two major tax-shelter industries, oil and gas drilling and real estate, rose by 63 percent, from some 205,000 to almost 334,000 thousand. Partnership formation in these tax-shelter industries accelerated between 1975 and 1982, with the number of partnerships increasing by 84 percent to a little over 613,000.

- Between 1979 and 1982, 41 percent of the growth in all partnerships and 74 percent of the growth in the total number of partners occurred in limited partnerships.

The rapid growth in the number of partnerships reporting losses would lack a sound business rationale if it were not for the ability of many taxpayers to use the tax losses produced by these partnerships to shelter other income from taxation.

- o Between 1965 and 1982, the number of partnerships with positive net income in all industries rose by only 16 percent, from 684,000 to 791,000.

- o By comparison, the number of loss partnerships more than tripled during the same period: from 229,000 in 1965 to 723,000 in 1982.

Among partnerships with losses, the growth has been particularly rapid in two industries.

- o Between 1965 and 1982, the number of partnerships reporting losses in the oil and gas and real estate industries more than quadrupled. From 80,000 in 1965, the number doubled to 165,000 in 1975, and then more than doubled again to 350,000 by 1982.

While the statistics cited above indicate that tax-shelter activity has been growing rapidly, they say nothing about the importance of tax shelters in the overall economy and their distorting effect on the allocation of resources. Data from the Securities and Exchange Commission document that "tax shelters" have become a significant factor in the market for newly issued securities. (Table 4)

- o In 1982 public offerings of tax shelter limited partnerships in oil and gas and in real estate equaled some $8.1 billion--almost 13 percent of all cash security offerings, and 31 percent of all cash equity offerings.

V. Conclusion

Nearly half of the high income taxpayers in 1983 paid a substantial share of their income in taxes--47 percent paid taxes of at least 20 percent of their positive income. These high-income taxpayers made hardly any more use of special provisions of the tax code for reducing tax liability than did typical upper-middle-income returns.

Table 4

Limited Partnerships and Publicly Offered Tax Shelters

1979 and 1982

	1979	1982
Number of partnerships 1/		
All partnerships	1,299,593	1,514,212
Limited partnerships	136,112	225,006
Number of partners 1/		
All partnerships	6,594,767	9,764,667
Limited partnerships	2,352,378	4,710,080
New public offerings 2/ (in billions)		
All cash offerings	$37.6	$63.7
Cash equity offerings	$10.4	$26.3
Tax shelter limited partnerships 3/	$ 2.3	$ 8.1

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1/ Statistics of Income, Business Income Tax Returns, Selected Years.

2/ Securities and Exchange Commission, Registered Offering Statistics file.

3/ Public offerings of limited partnership interests in oil and gas drilling and real estate ventures which, in the opinion of SEC legal staff, promise significant benefits based on tax savings to the prospective investor and therefore are classified as tax shelters by the SEC.

A significant minority of the high-income returns, however, paid virtually no tax. Nearly 30,000 (or 11 percent) of the returns with TPI above $250,000 paid no more than 5 percent of TPI in taxes. Over 3,000 (or 11 percent) of returns with at least $1 million in TPI paid virtually no tax. These high-income, low-tax returns look very different from both those of typical upper-middle-income taxpayers and those of high-income taxpayers who pay at least 20 percent of TPI in taxes.

The evidence discussed in this paper supports the presumption that tax-shelter partnerships are an important vehicle for high-income individuals to reduce their tax liabilities. For the high-income returns examined here that report less than 5 percent of positive income paid in taxes, losses on current business activities--including Schedule C, partnerships, rental and royalty properties, and farms--form the largest offset to positive income. Partnership losses are by far the largest component of current business losses.

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Office of Tax Policy
July 31, 1985

ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

Analysis of Partnership Activity

Office of the Secretary of the Treasury

Office of Tax Analysis

September 18, 1985

Analysis of Partnership Activity

I. Data Sources and Limitations.

The attached tables provide information regarding partnership operations as compiled from the IRS Statistics of Income Partnership data files for 1981-83. Although a legal entity, a partnership is not taxed on the income it earns. Instead, the individual partners are generally taxed on their share of partnership earnings, whether or not they receive any actual partnership distributions.1/ The partnership files an information return, Form 1065, with the IRS and also provides an information return, Schedule K-1 (Form 1065), to each partner. Schedule K-1 indicates the partner's share of the various items of partnership income and expense so that the partner has the necessary information in order to file the required tax returns. A copy of each Schedule K-1 is attached to the Form 1065 as filed with the IRS. An additional information return, Schedule K, which summarizes the information contained on the individual Schedule K-1s, is also attached to the Form 1065. However, for 1983 and later years, if the partnership has 10 or fewer partners it may elect not to file a Schedule K. (See attachments for copies of these forms.)

Only the information reported on the partnership Form 1065, and certain information reported on Schedule K (if filed by the partnership) is compiled by the IRS Statistics of Income Division. The "bottom line" of the Form 1065 indicates the amount of ordinary income or loss which is to be allocated to the individual partners in accordance with their profit (or loss) sharing ratios. However, items of income or expense which are specially allocated to individual partners, and items of income or expense which are subject to special treatment (such as capital gains) or are subject to special limitations or elections at the partner level (such as investment interest expense or intangible drilling costs) are not included on the Form 1065. Most of these items are instead reported on Schedules K-1 and K, but some (such as oil and gas depletion) are not reported on either the Form 1065 or Schedules K-1 or K. In short, the Form 1065 net ordinary income or loss does not necessarily reflect all of the partnership income or expense items.

Because some items may not be reported on either the Form 1065 or Schedule K, while other items, although reported on Schedule K, are not compiled by the IRS Statistics of Income Division (such as short term capital gains), or may not be picked up because no Schedule K was filed, it is not possible to calculate the total income or loss incurred by partnerships without the use of estimating procedures. In this study, the most significant items which could not be directly determined, but instead had to be inferred from other available information, are those related to mineral extraction. In particular, oil and gas

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1/ A corporation, trust, estate, individual, or other partnership may be a partner in a partnership.

depletion, hard mineral exploration and development costs, and intangible drilling costs (including dry hole costs) all had to be estimated. Although in principle the reported investment interest expense for 1983 should also be adjusted for the fact that partnerships with 10 or fewer partners were not required to file a Schedule K, it was not possible to discern a consistent method for doing so, and thus such adjustment was not made. The specific methods used to infer the mineral extraction costs are described in the Appendix to this note.

In addition to the need to estimate certain items which were not explicitly tabulated, certain other adjustments were necessary in order to obtain an amount which represents the contribution to taxable income reported by the partners as a result of partnership activities. Although guaranteed payments to partners are reported as a partnership expense on the Form 1065, they also represent income which must be reported by the partner (or partners) receiving such payments, and thus were added back to the Form 1065 "bottom line" income to reflect more clearly the total income required to be reported by the partners. In addition, a partnership may incur gains or losses through its ownership of interests in other partnerships. Since inclusion of such amounts would represent a "double counting" of aggregate partnership income, such amounts should be deducted from the Form 1065 "bottom line" income or loss. However, since the activity of partnerships which are characterized as "holding companies" would be distorted if such income were eliminated, for this one industry only such adjustment was not made.

II. Table One: Growth in Partnership Activity.

Table 1 provides summary statistics for partnerships filing returns in SOI years 1981-83. The number of partnerships and the number of partners, both in total and disaggregated by type of partnership (general or limited), are shown. The total assets and the partnership income reported, together with the adjustments necessary to reflect the contribution to the taxable income reported by the partners with respect to their partnership interests, are also noted. The purpose of this table is to indicate the overall level of partnership activity and the growth of such activity in the last few years. Some joint ventures engaged in investment, mineral extraction, or joint production or use arrangements which do not involve the selling of services or property may elect not to be considered as partnerships, and would thus not be included in these statistics.

In each case, the number of partnerships, number of partners, total partnership assets, and gross receipts plus gross rents are presented in order to show the growth in partnership activity. It may be noted from this table that whereas the number of partners in general partnerships has remained fairly steady, the number of partners in limited partnerships (and the number of such partnerships) has increased rapidly from 1981 to 1983.

Starting from the Form 1065 "bottom line", a series of adjustments were made to obtain an amount more reflective of the total taxable income which the partners must report as a result of their ownership of partnership interests. The first adjustment consisted of subtracting the income reported as earned from ownership of other partnership interests and adding back the guaranteed payments to partners. For convenience, this adjustment also involved the subtraction of the estimated dry hold costs and non-oil and gas depletion reported on the Form 1065 so that these specific costs may be included with the estimated "mineral exploration costs" also shown in this table.

From the resulting "adjusted Form 1065" partnership income (or loss), several additional adjustments were made. These essentially involved those items of income or expense reported on the Schedule K rather than on Form 1065. Because foreign income and Section 1231 (or specially allocated) losses were not compiled for 1981 and 1982, the 1983 values were assumed for those years. Investment interest expense was not compiled in 1981, and thus the 1982 value (scaled to reflect the relative the 1981 and 1982 partnership long term debt) was used for the 1981 value.

As a result of these adjustments, a "net ordinary income or loss" was obtained. To this income, 40% of the long term capital gains and Section 1231 (and specially allocated) gains should be added to obtain the "contribution to partner's taxable income (before investment tax credit)". Unfortunately, the Section 1231 gains are not available for 1981 and 1982, and thus only the net ordinary partnership income or loss is shown for those years. Likewise, the "contribution to taxable income (after credits)" is the total effective taxable income which would have been reported by the partners if their share of the investment tax credit earned by the partnership were expressed as an equivalent deduction (as described more fully in the following section).

Some caveats must be noted with reference to the information presented in Table 1 (and the following tables). First, it has been assumed that net IRC Section 1231 gains reported by the parnership will ultimately be treated as long term capital gains by the partners (and conversely that net Section 1231 losses will be treated as an ordinary loss by the partners). Second, limitations imposed by the tax laws on the amount of partnership losses which may be claimed by a partner, such as that due to inadequate basis in his partnership interest (IRC Section 704(d)), the "at risk" limitations (IRC Section 465), the investment interest expense limitation (IRC Section 163(d)), etc., have been ignored. Third, potential tax liabilities resulting from each partner's share of partnership tax preference items under the alternative minimum (or corporate minimum) tax are ignored. Fourth, any gains or losses which must be reported by individual partners resulting from their receipt of partnership distributions or sale of their partnership interest are ignored. And finally, not all partners are individuals, and thus the use of a 60% exclusion for

capital gains income and the use of effective individual tax rates to translate the tax benefits associated with the investment tax credits into a single statistic, the "contribution to partner's taxable income after ITC", may be subject to error.

It may be noted that, in aggregate, general partnerships appear to incur positive net ordinary income, while limited partnerships incur ordinary losses. Moreover, the net income for the general partnerships clearly reflected the 1983 recovery from the 1980-81 recession.2/ By contrast, the ordinary losses of the limited partnerships continued to grow, despite the 1983 upturn. It may also be noted that the estimated mineral exploration costs for both the general and limited partnerships declined from 1981 through 1983. This largely reflected the cutback in oil and gas drilling activity over this period in response to the decline in oil prices.

III. Table Two: Breakdown by Industry.

In Table 2 the income and expenses reported by (or imputed to) partnerships in 1983 are disaggregated by the nature of the partnership activity. Summary statistics for all major SOI industrial sectors, and for each industrial sub-sector for which aggregate partnership losses exceed $100 million, are presented. The purpose of this table is to indicate the level of partnership activity across industries, as well as to indicate the relative magnitude of the interest, depreciation, mineral exploration costs, and all other partnership deductions, and investment tax credits incurred in each industry. Thus, only the estimated mineral exploration costs, net ordinary income, investment tax credit, and contribution to partner's taxable income after credits are aggregated in the same fashion as in Table 1.

The total ordinary income shown in column two of this table represents the sum of the gross income, gross rents, nonqualifying interest and dividend income, net farm and royalty income, net ordinary income from the sale of partnership assets, and other income reported on the Form 1065, plus net Section 1231 losses and foreign source income reported on the Schedule K. Note that income from other partnerships is excluded from the aggregate amount and from the partnership income reported for each industry (with the exception of partnerships characterized as "holding companies").

The deductions shown in the third column of Table 2 include salaries and wages, rent, taxes, bad debts, repairs, rental expenses (other than interest and depreciation), and other deductions shown on the Form 1065. Note that guaranteed payments to partners, interest expense, depreciation, depletion (other than

2/ The temporal behavior of the net income reported by general partnerships (but not limited partnerships) matches rather closely the corresponding behavior of corporate profits.

oil and gas), and estimated dry hole costs (see Appendix) are excluded. (The dry hole costs are included with the other mineral exploration costs).

Interest expense, depreciation, and estimated mineral exploration costs (depletion, hard mineral exploration and development costs, and intangible drilling costs, including dry hole costs) are presented in columns four through six. The interest expense shown is the sum of the net interest reported on Form 1065 and the investment interest expense reported on Schedule K, plus the reported rental interest expense. The depreciation expense shown is the sum of depreciation reported on Form 1065 and depreciation of rental property as listed in the rental expense schedule. The estimated mineral exploration costs are obtained as noted in the Appendix. The net ordinary partnership income or loss is noted in column seven. As has already been noted, because some items of income and expense are not reported on the Form 1065, and because of our adjustments for income from other partnerships and guaranteed payments to partners, the amounts shown in this column will not be the same as that shown in the SOI Partnership Returns reports, which utilize only Form 1065 information.

The total long term capital gain shown in column eight is the sum of the long term capital gains and net Section 1231 gains reported on the Schedule K. By adding 40% of this amount to the amount shown in column seven, the total contribution to the taxable income required to be reported by the partners is obtained.

The investment tax credit obtained from Schedule K is shown in column nine of this table. Using an effective individual tax rate of 24% for loss partnerships and 29% for gain partnerships (as obtained from an analysis of the individual SOI data files), this investment credit may be converted into an equivalent deduction. Subtracting this equivalent deduction from the taxable income as obtained above, an effective total contribution to taxable income after credits required to be reported by the partners is obtained, as shown in the last column of this table.

From this table it may be seen that although partnerships may engage in all types of business, partnerships appear to be especially active in oil and gas extraction, construction, wholesale and retail trade, land development, and service activities. As expected, mineral exploration costs (depletion and intangible drilling costs, including dry hold costs) are a major factor in oil and gas extraction, while depreciation and interest deductions play an important role in real estate operations. Depreciation is also important in oil and gas extraction and equipment leasing, while interest expense deductions are an important factor in holding and investment company activity.

IV. Table Three: Summary of Partnership Characteristics

Summary statistics for 1983, by industry and type of partnership, of various partnership attributes, including various measures of debt financing, are presented in Table 3. The activity of limited and general partnerships was seen from Table 1 to differ. The purpose of this table is to further explore the differences between such partnerships. In particular, the industrial composition and financing arrangements are examined. Note that the amounts shown in columns seven and eight are the ratios of the partnership debt to the partners' capital account (which in some instances may be negative).

It may be noted that in some industries, such as manufacturing, construction, electic and gas services, and beef cattle (except feedlots), the fraction of partnerships which are operated as limited partnerships is relatively low. By constrast, in other industries, such as oil and gas extraction, real estate operators and lessors of buildings, and motion picture and video production, limited partnerships constitute a significant fraction of total partnerships.

It may also be noted that the average number of partners in each limited partnership is much larger than the average number of partners in general partnerships in nearly all industries. Moreover, fewer limited partnerships incur positive ordinary income than general partnerships. This, of course, is consistent with the fact (as noted in Table 1) that in aggregate general partnerships exhibit ordinary gains while limited partnerships report ordinary losses.

Greater financial leverage may be seen from this table to be used in those industries where the underlying assets may serve as security (such as real estate, motels and hotels, and equipment leasing). A greater fraction of non-recourse debt is used by limited partnerships. Whereas a partner in a general partnership may increase his tax basis in his partnership interest by his share of partnership debt, this is not generally the case for a limited partner. A limited partner may, however, increase his basis in his limited partnership interest by his share of the non-recourse debt incurred by the partnership. However, since such debt does not generally benefit partners subject to the "at risk" limitation, it is also not surprising that a particularly large fraction of non-recourse debt is used in the real estate industry, which under current law does not generally subject the partners to the "at risk" limitations.

V. Table 4: Breakdown by Age of Partnership.

Table 4 shows how the various items of partnership income and expense vary by age of the partnership. The purpose of this table is to demonstrate the fact that the losses usually arise in the early years of the partnership, whereas net gains are typically not incurred until later in the partnership's life.

By examining the pattern of partnership receipts and expenses as a function of the age of the partnership, the temporal behavior of the taxable income that might be reported by the "typical" partnership may be inferred. The distribution of income and expense items by age of partnership is not, however, a perfect proxy for the actual temporal behavior of any individual partnership. Business cycles and secular economic growth cannot, of course, be captured. In order to adjust for the rapid growth in limited partnership activity, both the aggregate dollar amounts and the amount per partner are presented.

From the table it may be seen that the newly formed partnerships (both limited and general) incur ordinary losses, whereas the older partnerships incur positive ordinary income (or capital gains). However, the per partner losses appear to be somewhat greater for the limited partnerships than for the general partnerships. Moreover, the gross ordinary income also appears to increase more with partnership vintage for general partnerships than for limited partnerships.

Appendix: Imputation of Mineral Extraction Costs

The method of reporting certain items of partnership expense and income has varied. For a number of years oil and gas depletion had been calculated at the partner level, and the depletion expense was not reported on either the Form 1065 or Schedule K. For the returns examined, a number of other items, including hard mineral exploration and development expenses and intangible drilling costs, were to be reported on Schedule K, but this item was not compiled by the IRS Statistics of Income Division. (After 1983, intangible drilling costs are not reported on either the Form 1065 or Schedule K).3/

Although hard mineral exploration and development costs and the intangible drilling costs were not compiled, certain tax preference items related to these costs were picked up from Schedule K. In particular, "excess intangible drilling costs from oil, gas, or geothermal wells", "net income from oil, gas, or geothermal wells", and "other" tax preference items were tabulated for partnerships filing a Schedule K.

3/ It is possible that some partnerships may have reported intangible drilling costs as part of the "other deductions" shown on the Form 1065. To the extent this occurred, the losses shown for this industry may be somewhat overstated.

In order to estimate intangible drilling costs attributable to successful wells, the reported "excess intangible drilling costs" were increased by an estimated 10%. This was done in order to adjust for the fact that the reported "excess" amount under current law is net of the deduction for intangible drilling costs which would have been claimed had these costs been capitalized and either amortized over 10 years or written off on a units of production basis.

The hard mineral depletion expense was obtained directly from Form 1065. It was assumed that the hard mineral exploration and development costs constitute the "other" tax preference reported on Schedule K by partnerships in the mining industry. These costs were found to be relatively minor in comparison with the corresponding depletion expense obtained directly from the Form 1065.

The oil and gas depletion claimed was estimated as the lesser of 15% of the gross receipts or 50% of the "net income from oil, gas, and geothermal wells" for those oil and gas partnerships that filed a Schedule K. This estimate is only approximate, for the "net income from oil, gas, and geothermal wells" does not take into account "excess intangible drilling costs" on productive property. It was thus implicitly assumed that such "excess intangible drilling costs" were incurred on non-productive properties (and thus did not affect the percentage depletion claimed, which is calculated on a property by property basis). It was also implicitly assumed that production from all of the productive properties would qualify for percentage depletion. Thus the estimate may overstate the actual percentage depletion claimed.

Since the "excess intangible drilling costs" may be obtained only for those oil and gas partnerships which filed a Schedule K the computed intangible drilling costs were scaled up by the ratio (1.575) of the "other" deductions for oil and gas partnerships to the "other" deductions reported on the Form 1065 for those oil and gas partnerships which did file a Schedule K. Likewise, the percentage depletion for those oil and gas partnerships not filing a Schedule K were imputed by scaling up the computed depletion by the factor 1.867, which is the ratio of the gross receipts for all oil and gas partnerships to the gross receipts reported by those oil and gas partnerships filing a Schedule K. These adjustments, which were required to compensate for the fact that not all partnerships filed a Schedule K in 1983, were not necessary for 1981 and 1982. As a test of the accuracy of these adjustments, the relative magnitude of the 1981, 1982, and 1983 estimated intangible drilling costs were compared with the level of drilling activity in these years. Despite the several assumptions, it was found that the pattern of computed intangible drilling costs matched nearly exactly the pattern of rotary rig activity and reported industry wide drilling expenditures during those years.

In addition, the dry hole costs (which should have been included in the "other" deductions on the Form 1065) were taken to be 3/7 of the intangible drilling costs incurred on successful wells. This is the 1982 industry-wide ratio of dry hole costs to the drilling costs of successful wells. For convenience, these estimated dry hole costs were subtracted from the "other" deduction reported on the Form 1065 and added to the estimated intangible drilling costs on successful wells. Because the ratio of dry hole costs to successful well costs is likely to be greater for partnership ventures than for the overall industry, the resulting estimated intangible drilling costs (including dry hole costs) would tend to understate the actual costs. This should offset the possible overstatement of the percentage oil and gas depletion claimed.

Table 1. Growth in Partnership Activity (Dollar amounts in billions)

	All partnerships			Limited partnerships			General partnerships		
	1981	1982	1983	1981	1982	1983	1981	1982	1983
Number of partnerships	1460502	1514212	1541539	208204	225886	233986	1252298	1288326	1307553
Number of partners 1/	9095165	9764667	10589338	4176572	4709723	5434870	4918593	5054944	5154468
Total partnership assets	715.2	845.3	887	282.4	331.7	381.4	432.8	513.6	505.6
Gross receipts and gross rents	281.6	312.2	313.5	55.7	70.3	70.9	225.9	241.9	242.6
Form 1065 income or loss	-2.7	-7.3	-2.6	-15.7	-17.5	-18.7	13	10.2	16.1
Less income from other partnerships, plus dry hole costs, non-oil and gas depletion, and guaranteed payments to partners	14	15.4	14	5.8	5.8	5.5	8.2	9.6	8.5
Adjusted Form 1065 income or loss	11.3	8.1	11.4	-9.9	-11.7	-13.2	21.2	19.8	24.6
Items not reported on Form 1065:									
Plus foreign income	1.4	1.4	1.4	.1	.1	.1	1.3	1.3	1.3
Less mineral exploration costs	-12.7	-10.3	-8	-5.9	-4.6	-4.1	-6.8	-5.7	-4
Less investment interest expense	-4.9	-5.8	-5.1	-1.9	-2.2	-2.7	-3	-3.6	-2.4
Less Sec. 1231 and spec. alloc. loss	-.9	-.9	-.9	-.3	-.3	-.3	-.6	-.6	-.6
Net ordinary income or loss	-5.8	-7.5	-1.1	-17.9	-18.7	-20.1	12.1	11.2	19
Capital gains	5.5	7.1	8.8	1.7	2.2	2.2	3.8	4.9	6.6
Sec. 1231 or spec. alloc. gains			7.1			3.5			3.6
Contribution to partner's taxable income before ITC 2/			5.2			-17.8			23
Investment tax credit	1.5	.1	1.7	.5	.7	.8	1	-.6	.9
Contribution to partner's taxable income after ITC 3/			-.9			-20.6			19.6
Percent of partnerships with positive total ordinary income	45.1	52.3	50.9	18.9	38.1	34.6	48.6	54.7	53.8

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1/ Includes partners that are corporations and partnerships, as well as indivduals.

2/ Contribution to partner's taxable income before ITC equals ordinary income plus 40% of total capital and Sec. 1231 gains.

3/ Contribution to partner's taxable income after ITC equals ordinary income plus 40% of total capital and Sec. 1231 gains less the investment tax credit divided by an average marginal tax rate.

Table 2. Summary of 1983 Partnership Income and Deductions by Industry (in Millions of Dollars)

	Gross Ordinary Income 1/	Deductions Other Than Deprec., Interest, Min.Exp. Costs 2/	Interest	Deprecia-tion	Estimated Mineral Explor-tion Costs 3/	Net Ordinary Income	Capital Gain	Investment Tax Credit	Contri-bution to Taxable Income (After ITC)
All	213517.7	126102.5	48215.4	32285.5	8045.5	-1131.6	15942	1713.8	-947.3
All Agric.	3396.8	2216.6	474.1	457.8		248.3	746.4	105.9	157.5
Fruit Trees	-84.9	106.5	42	35		-268.4	51.4	21.2	-323.7
Beef,ex.feedlots	57.7	202	65.5	47.8		-257.6	171.2	13.9	-237.9
Livestock	-21.4	61.2	7.7	47.1		-137.4	18.1	7	-154.2
All Mining	12996.2	10089.9	1394.7	2563.2	7887.1	-8938.7	274	163.2	-9435.4
Metal	558	452.2	122.4	228.8	90.3	-335.7	20.9	9.9	-362.5
Coal	763.1	584	118.2	147.5	108.8	-195.4	20.8	2.5	-196.9
Oil	11404	8889.7	1114.1	2127.9	7656.8	-8384.5	227.6	141.6	-8820.2
Construction	6688.9	3194.9	553.7	480.1		2460.2	178.4	12.6	2483.4
All Manufacturing	3332	2857.6	403.6	727.8		-657	113.9	128.2	-1065.4
Lumber	449.5	314.9	99.4	128.5		-93.3	66	22.4	-145.4
Chemicals	189.6	469.7	94.6	184.9		-559.6	6.2	19.1	-626.6
All Transportation	5005.7	2918.8	855.9	1292.6		-61.6	46	128.2	-474.2
Water	406.7	178.9	169.3	206.6		-148.1	.2	.9	-151.8
Communication	1114.1	984.2	234	339.1		-443.2	.2	40.1	-600.3
Electric	346.7	456.9	161	237.5		-508.7	4.1	39.6	-653.8
Wholesale Trade	3034.8	2019.8	325.2	221.2		468.6	54.4	6.4	465.7
Retail Trade	13011.7	9937.6	550.2	763.4		1760.5	84.2	1.9	1655.9
All finance	96918.9	50764.5	38830	18910.1	83.2	-11668.9	13833.7	653.8	-8460
Real Estate	68994.1	38237.9	26777.7	16780.7		-12802.2	6987.7	8.9	-11534.8
Subdividers	4991.7	2754.8	2827.3	486.5		-1076.9	409.9	44.3	-1069.9
Holding companies 4/	7081.6	3179.7	3483	968.6	409.9	-959.6	3985.9	103.7	265.2
All services	68824.9	41983.2	4814	6848.4		15179.3	609.9	488	13631.5
Hotels	4233.3	3336.2	988.7	763.7		-855.3	108.5	67.4	-1048.2
Motels	3511.4	2366.6	691.6	572.8		-119.6	53.8	20.8	-173.6
Equipment leasing	4038.2	1287	1316.1	2305.2		-870.1	18.8	130.9	-1329.2
Motion pictures	1113.5	852.4	70.8	396		-205.7	23.2	90.2	-527.2
Racing	41.5	122	3.9	70.8		-155.2	.6	1	-158.4
Other Amusement	1845.2	1415.8	217.2	389		-176.8	21.1	27.5	-267.6

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1/ Net of cost of goods sold and net income from other partnerships.

2/ Excludes guaranteed payments to partners.

3/ Includes estimated depletion, hard mineral exploration and development costs, and intangible drilling costs (including dry hole costs).

4/ Includes income and expenses from other partnerships.

Table 3. Summary of 1983 Partnership Characteristics by Industry and Type of Partnership.

	Number of Partnerships		Average Number of Partners		Percent Formed In Period 1981-3		Ratio of Debt to Equity		Nonrecourse Debt as Pct.Total Debt		Percent With Positive Income	
	Limited	General	Limited	General	Limited	General	Limited	General	Limited	General	Limited	General
All	233986	1307552	23.2	3.9	44.6	37.5	9.5	3.8	33.3	15.6	34.6	53.8
All Agric.	9198	127405	13.1	2.7	39.4	23.8	2	5.3	15.5	1.9	25.7	55.8
Fruit Trees	2461	9630	13	2.6	62.2	10.6	5.4	3.1	28	7.4	23.7	53.1
Beef,ex.feedlots	408	18444	15.4	2.4	9.8	11.1	1.4	9.9	.7	11.2	53.2	32.8
Livestock	633	1636	20.2	2.9	76.2	88.6	2.1	1.9	0	3.7	.5	10
All Mining	23418	36117	67.5	26.3	52.7	64.2	1.2	.6	15.5	10.3	34.3	44.3
Metal	1509	284	31.6	80.5	32.5	17	.5	1	4.3	2	.7	14.3
Coal	183	369	67.2	3.3	8.9	43.7	-1.2	.4	64.5	11.3	2.8	46
Oil	20913	35259	72.2	13.5	56.6	52.2	.9	.6	7.9	10.7	36	44.3
Construction	1592	62000	5.3	2.3	77.4	48.5	-36.9	3.1	26.4	3.2	49.8	72.4
All Manufacturing	786	25665	35.5	2.4	57.8	45.6	12.7	1.8	48.3	5.6	17.8	48.1
Lumber	23	4366	58.6	2.5	25.9	6	5.2	1.7	61.5	25.3	65.3	69.1
Chemicals	172	136	44.9	2.4	94.2	39.8	1.8	1.3	14.3	0	3.6	77.1
All Transportation	2397	17735	22	2.8	74.3	49.4	4.2	1	28.9	14.4	18.8	48.3
Water	291	363	16.1	4.8	16.5	64.9	15.9	-206	30.2	42.4	8.3	28.6
Communications	449	3081	76.4	4.3	67.3	63.5	4.4	4.6	17.5	2.8	41.4	35.2
Electric	67	1318	81.9	2.1	83.3	5.6	1.3	.3	20.6	3.1	19.8	19.4
Wholesale Trade	1323	22792	10	2.4	10.4	49.3	4.9	2.5	19.4	1.2	15.5	67.3
Retail Trade	6171	161982	6	2.3	31.2	44.3	1.6	1.6	6.7	3.8	60	50.6
All finance	163384	566683	19.5	4.8	41.6	31.3	12.8	5.5	40.2	18.2	34.7	47.7
Real Estate	109491	382210	20.2	3.8	44.9	32	57.9	11.1	54.9	24.5	30	44.6
Subdividers	11280	31390	12.2	.1	39.9	42.4	11	6.8	28.4	15	33.3	39.2
Holding companies	28762	79993	18.6	5.4	28.8	17.8	1.5	2.6	20.4	13.7	50.1	60.4
All services	25538	280756	15.6	3.1	57.9	45.4	103.1	4.4	33.4	12.8	33.4	63.9
Hotels	994	2080	20.6	4.1	45.4	46	-33.9	7.9	49.3	28.3	13.1	39.2
Motels	1430	5968	25.8	3.3	48.1	23.4	-51.7	9.2	37	11	2.6	63.7
Equipment leasing	4693	31642	26.1	3.4	68.2	42.8	-49.4	-26.5	18.3	25.1	51	52.4
Motion pictures	1793	2589	13	10.6	5.8	66.2	-5.9	2	34	2.9	32.4	44
Racing	8	3940	11.4	3.1	74.5	50.3	1.4	.5	0	4.3	25.6	12.3
Other Amusement	679	6849	21.3	3	28.7	62.5	247.7	5.8	1.4	4.6	20.5	24.9

Office of the Secretary of the Treasury
Office of Tax Analysis

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Table 4. Summary Statistics for 1983 Partnerships by Year Partnership was Formed.

	All Partnerships					Limited partnerships					General Partnerships				
	1983	1981-82	1978-80	1973-77	Before 1973	1983	1981-82	1978-80	1973-77	Before 1973	1983	1981-82	1978-80	1973-77	Before 1973
Number partnerships	231876	363329	350045	260495	335794	41856	62571	59246	40739	29574	190020	300758	290799	219756	306220
Number of partners	1803995	3186395	2215785	1430118	1950960	1183324	1922779	1193633	668654	466480	620671	1263616	1022152	761464	1484480
Aggregate Amount (in billions of dollars):															
Gross profit	10.80	42.00	48.10	39.40	73.20	2.80	13.50	15.80	10.60	13.10	8.00	28.50	32.30	28.80	60.10
Deductions exc. deprec., int., min. exp. costs	12.80	27.70	25.50	20.60	39.50	5.40	10.20	8.60	5.10	6.80	7.40	17.50	16.90	15.50	32.70
Interest expense	3.50	15.20	14.30	7.60	7.60	2.00	7.50	6.80	2.90	3.40	1.50	7.70	7.50	4.70	4.20
Depreciation	2.80	10.80	9.00	5.10	4.60	1.50	5.00	4.00	1.70	.90	1.30	5.80	5.00	3.40	3.70
Est. mineral exp. cost	4.60	2.00	.80	.50	.50	2.30	1.30	.40	.20	.10	2.30	.70	.40	.30	.40
Net Ordinary Income	-12.90	-13.70	-1.50	5.60	20.90	-8.40	-10.50	-4.00	.70	2.00	-4.50	-3.20	2.50	4.90	18.90
Capital gain	.40	1.90	3.90	3.30	6.40	.10	.90	2.10	1.20	1.50	.30	1.00	1.80	2.10	4.90
Contribution to Taxable Income (aft ITC)	-12.30	-15.30	-.70	6.50	23.00	-8.50	-11.30	-3.40	1.10	2.50	-3.80	-4.00	2.70	5.40	20.50
Per Partner (in dollars):															
Gross profit	5986.71	13181.04	21707.88	27550.17	37519.99	2366.22	7021.09	13236.90	15852.74	28082.66	12889.28	22554.32	31600.00	37821.88	40485.56
Deductions exc. deprec., int., min. exp. costs	2549.90	627.67	361.05	349.62	256.28	1943.68	676.10	335.11	299.11	214.37	3705.67	553.97	391.33	393.98	269.45
Interest expense	7095.36	8693.21	11508.34	14404.41	20246.44	4563.42	5304.82	7204.89	7627.26	14577.26	11922.58	13849.14	16533.74	20355.53	22027.92
Depreciation	1940.14	4770.28	6453.69	5314.25	3895.52	1690.15	3900.60	5696.89	4337.07	7288.63	2416.74	6093.62	7337.46	6172.32	2829.27
Est. mineral exp. cost	1552.11	3389.41	4061.77	3566.14	2357.81	1267.62	2600.40	3351.11	2542.42	1929.34	2094.51	4590.00	4891.64	4465.08	2492.46
Net Ordinary Income	-7150.80	-4299.53	-676.96	3915.76	10712.67	-7098.65	-5460.85	-3351.11	1046.88	4287.43	-7250.22	-2532.41	2445.82	6434.97	12731.73
Capital gain	221.73	596.29	1760.10	2307.50	3280.44	84.51	468.07	1759.33	1794.65	3215.57	483.35	791.38	1760.99	2757.85	3300.82
Contribution to Taxable Income (aft ITC)	-6818.20	-4801.66	-315.92	4545.08	11789.07	-7183.16	-5876.91	-2848.45	1645.10	5359.29	-6122.41	-3165.52	2641.49	7091.60	13809.55
Debt to equity ratio	3.88	5.21	7.91	14.48	2.95	3.55	5.41	22.35	-12.12	-60.77	4.43	5.06	4.90	6.02	1.71
Non-recourse debt to equity ratio	1.08	1.15	2.26	4.59	.68	1.30	1.83	8.93	-6.33	-20.78	.72	.61	.87	1.11	.27
Percent non-recourse debt	27.84	22.07	28.57	31.70	23.05	36.62	33.83	59.96	52.23	34.19	16.25	12.06	17.76	18.44	15.79

Office of the Secretary of the Treasury
Office of Tax Analysis

September 17, 1985

Form **1065**

Department of the Treasury
Internal Revenue Service

U.S. Partnership Return of Income

▶ For Paperwork Reduction Act Notice, see Form 1065 Instructions.

For calendar year 1983, or fiscal year beginning ...., 1983, and ending ...., 19...

OMB No. 1545-0099

1983

A Principal business activity (see page 4 of Instructions)

B Principal product or service (see page 16 of Instructions)

C Business code number (see page 16 of Instructions)

Use IRS label. Otherwise, please print or type.

Name

Number and street

City or town, State, and ZIP code

D Employer identification number

E Date business started

F Enter total assets at end of tax year
$

G Check method of accounting: (1) ☐ Cash (2) ☐ Accrual (3) ☐ Other

H Check applicable boxes: (1) ☐ Final return (2) ☐ Change in address (3) ☐ Amended return

I Check if the partnership meets *all* the requirements shown on page 4 of the Instructions under Question I . . . . ▶ ☐

J Number of partners in this partnership ▶ ....

	Yes	No
K Is this partnership a limited partnership (see page 3 of Instructions)?		
L Is this partnership a partner in another partnership?		
M Are any partners in this partnership also partnerships?		

	Yes	No
N (1) Was there a distribution of property or a transfer of a partnership interest during the tax year?		
(2) If "Yes," is the partnership making an election under section 754? If "Yes," attach a statement for the election. (See page 4 of the Instructions before answering this question.)		
O At any time during the tax year, did the partnership have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country (see page 4 of Instructions)?		
P Was the partnership the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not the partnership or any partner has any beneficial interest in it? If "Yes," you may have to file Forms 3520, 3520-A, or 926. (See page 5 of Instructions.)		
Q Are there any specially allocated items of income, gain, loss, deduction, credit, etc. (see page 5 of Instructions)		

Income

Line	Description		
1a	Gross receipts or sales $ .... 1b Minus returns and allowances $ .... Balance ▶	1c	
2	Cost of goods sold and/or operations (Schedule A, line 7)	2	
3	Gross profit (subtract line 2 from line 1c)	3	
4	Ordinary income (loss) from other partnerships and fiduciaries	4	
5	Nonqualifying interest and nonqualifying dividends	5	
6a	Gross rents $ .... 6b Minus rental expenses (attach schedule) $		
c	Balance net rental income (loss) ▶	6c	
7	Net income (loss) from royalties (attach schedule)	7	
8	Net farm profit (loss) (attach Schedule F (Form 1040))	8	
9	Net gain (loss) (Form 4797, line 14)	9	
10	Other income (loss)	10	
11	TOTAL income (loss) (combine lines 3 through 10)	11	

Deductions

Line	Description		
12a	Salaries and wages (other than to partners) $ .... 12b Minus jobs credit $ .... Balance ▶	12c	
13	Guaranteed payments to partners (see page 6 of Instructions)	13	
14	Rent	14	
15a	Total deductible interest expense not claimed elsewhere on return (see page 6 of Instructions) — 15a		
b	Minus interest expense required to be passed through to partners on Schedule K-1, lines 13, 20a(2), and 20a(3) and Schedule K, lines 13, 20a(2), and 20a(3) (if Schedule K is required). — 15b		
c	Balance ▶	15c	
16	Taxes	16	
17	Bad debts (see page 7 of Instructions)	17	
18	Repairs	18	
19a	Depreciation from Form 4562 (attach Form 4562) $ .... 19b Minus depreciation claimed on Schedule A and elsewhere on return $ .... Balance ▶	19c	
20	Depletion (*Do not deduct oil and gas depletion.* See page 7 of Instructions.)	20	
21a	Retirement plans, etc. (see page 7 of Instructions)	21a	
b	Employee benefit programs (see page 7 of Instructions)	21b	
22	Other deductions (attach schedule)	22	
23	TOTAL deductions (add amounts in column for lines 12c through 22)	23	
24	Ordinary income (loss) (subtract line 23 from line 11)	24	

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Signature of general partner ▶ Date

Paid Preparer's Use Only

Preparer's signature ▶ | Date | Check if self-employed ▶ ☐ | Preparer's social security no.

Firm's name (or yours, if self-employed) ▶ | E.I. No. ▶ | ZIP code ▶

SCHEDULE A.—Cost of Goods Sold and/or Operations (See Page 7 of Instructions.)

1	Inventory at beginning of year	1	
2	Purchases minus cost of items withdrawn for personal use	2	
3	Cost of labor	3	
4	Other costs (attach schedule)	4	
5	Total (add lines 1 through 4)	5	
6	Inventory at end of year	6	
7	Cost of goods sold (subtract line 6 from line 5). Enter here and on page 1, line 2	7	

8a Check all methods used for valuing closing inventory:

(i) ☐ Cost

(ii) ☐ Lower of cost or market as described in regulations section 1.471-4 (see page 8 of Instructions)

(iii) ☐ Writedown of "subnormal" goods as described in regulations section 1.471-2(c) (see page 8 of Instructions)

(iv) ☐ Other (specify method used and attach explanation) ▶ ....

b Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) ☐

c If you are engaged in manufacturing, did you value your inventory using the full absorption method (regulations section 1.471-11)? ☐ Yes ☐ No

d Was there any substantial change in determining quantities, cost, or valuations between opening and closing inventory? ☐ Yes ☐ No
If "Yes," attach explanation.

SCHEDULE B.—Distributive Share Items (See Pages 8, 10-11, and 15 of Instructions.)

	(a) Distributive share items		(b) Total amount
1	Net long-term capital gain (loss)	1	
2	Other net gain (loss) under section 1231 and specially allocated ordinary gain (loss)	2	
3a	If the partnership had income from outside the United States, enter the name of the country or U.S. possession ▶		
b	Total gross income from sources outside the United States	3b	

SCHEDULE L.—Balance Sheets
(See Pages 4 and 8 of Instructions and Question I on Page 1 Before Completing Schedules L and M.)

		Beginning of tax year		End of tax year	
	Assets	(a)	(b)	(c)	(d)
1	Cash				
2	Trade notes and accounts receivable				
a	Minus allowance for bad debts				
3	Inventories				
4	Federal and State government obligations				
5	Other current assets (attach schedule)				
6	Mortgage and real estate loans				
7	Other investments (attach schedule)				
8	Buildings and other depreciable assets				
a	Minus accumulated depreciation				
9	Depletable assets				
a	Minus accumulated depletion				
10	Land (net of any amortization)				
11	Intangible assets (amortizable only)				
a	Minus accumulated amortization				
12	Other assets (attach schedule)				
13	TOTAL assets				
	Liabilities and Capital				
14	Accounts payable				
15	Mortgages, notes, and bonds payable in less than 1 year				
16	Other current liabilities (attach schedule)				
17	All nonrecourse loans				
18	Mortgages, notes, and bonds payable in 1 year or more				
19	Other liabilities (attach schedule)				
20	Partners' capital accounts				
21	TOTAL liabilities and capital				

SCHEDULE M.—Reconciliation of Partners' Capital Accounts (See Page 8 of Instructions.)
(Show reconciliation of each partner's capital account on Schedule K-1, Item F.)

(a) Capital account at beginning of year	(b) Capital contributed during year	(c) Ordinary income (loss) from page 1, line 24	(d) Income not included in column (c), plus nontaxable income	(e) Losses not included in column (c), plus unallowable deductions	(f) Withdrawals and distributions	(g) Capital account at end of year

☆U.S. Government Printing Office: 1983—[illegible]

SCHEDULE K (Form 1065)

Department of the Treasury Internal Revenue Service

Partners' Shares of Income, Credits, Deductions, etc.

▶ File this form if there are more than ten Schedules K-1 to be filed with Form 1065.

Do not complete lines 6, 8, 21b, and 21c. The amounts for these lines are shown on Schedule B, Form 1065.

▶ Attach to Form 1065. ▶ See Instructions for Schedule K (Form 1065).

OMB No. 1545-0099

1983

Name of partnership | Employer identification number

	a. Distributive share items		b. Total amount
Income (Loss)	1 Ordinary income (loss) (page 1, line 24)	1	
	2 Guaranteed payments	2	
	3 Interest from All-Savers Certificates	3	
	4 Dividends qualifying for exclusion	4	
	5 Net short-term capital gain (loss) (Schedule D, line 4)	5	
	6 Net long-term capital gain (loss) (Schedule D, line 9)		
	7 Net gain (loss) from involuntary conversions due to casualty or theft (Form 4684)	7	
	8 Other net gain (loss) under section 1231		
	9 Other (attach schedule)	9	
Deductions	10 Charitable contributions (attach list): 50%..........., 30%..........., 20%...........	10	
	11 Expense deduction for recovery property (section 179) from Part I, Section A, Form 4562	11	
	12a Payments for partners to an IRA	12a	
	b Payments for partners to a Keogh Plan (Type of plan ▶ ....)	12b	
	c Payments for partners to Simplified Employee Pension (SEP)	12c	
	13 Other (attach schedule)	13	
Credits	14 Jobs credit	14	
	15 Credit for alcohol used as fuel	15	
	16 Credit for income tax withheld	16	
	17 Other (attach schedule)	17	
Other	18a Gross farming or fishing income	18a	
	b Net earnings (loss) from self-employment	18b	
	c Other (attach schedule)		
Tax Preference Items	19a Accelerated depreciation on nonrecovery real property or 15-year real property	19a	
	b Accelerated depreciation on leased personal property or leased recovery property other than 15-year real property	19b	
	c Depletion (other than oil and gas)	19c	
	d (1) Excess intangible drilling costs from oil, gas, or geothermal wells	19d(1)	
	(2) Net income from oil, gas, or geothermal wells	19d(2)	
	e Net investment income (loss)	19e	
	f Other (attach schedule)	19f	
Investment Interest	20a Investment interest expense:		
	(1) Indebtedness incurred before 12/17/69	20a(1)	
	(2) Indebtedness incurred before 9/11/75, but after 12/16/69	20a(2)	
	(3) Indebtedness incurred after 9/10/75	20a(3)	
	b Net investment income (loss)	20b	
	c Excess expenses from "net lease property"	20c	
	d Excess of net long-term capital gain over net short-term capital loss from investment property	20d	
Foreign Taxes	21a Type of income		
	b Foreign country or U.S. possession		
	c Total gross income from sources outside the U.S. (attach schedule)		
	d Total applicable deductions and losses (attach schedule)	21d	
	e Total foreign taxes (check one): ▶ ☐ Paid ☐ Accrued	21e	
	f Reduction in taxes available for credit (attach schedule)	21f	
	g Other (attach schedule)	21g	

For Paperwork Reduction Act Notice, see Form 1065 Instructions.

TREASURY NEWS

epartment of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 12:00 NOON September 20, 1985

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $8,300 million of 364-day Treasury bills to be dated October 3, 1985, and to mature October 2, 1986 (CUSIP No. 912794 KR 4). This issue will not provide new cash for the Treasury, as the maturing 52-week bill is outstanding in the amount of $8,311 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Thursday, September 26, 1985.

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.

The bills will be issued for cash and in exchange for Treasury bills maturing October 3, 1985. In addition to the maturing 52-week bills, there are $13,604 million of maturing bills which were originally issued as 13-week and 26-week bills. The disposition of this latter amount will be announced next week. Federal Reserve Banks currently hold $1,610 million as agents for foreign and international monetary authorities, and $5,369 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rate 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. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $75 million of the original 52-week issue. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-1.

B-284

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS
partment of the Treasury • Washington, D.C. • Telephone 566-2041

REMARKS BY
DIRECTOR OF THE MINT
DONNA POPE
AT THE NUMISMATIC THEATRE
AMERICAN NUMISMATIC CONVENTION
BALTIMORE, MARYLAND
August 24, 1985

Good afternoon. I hope everyone here is enjoying this really fine convention with cooperation from the weather on this beautiful day. I gather that since I was invited to speak to you again this year, you either must have enjoyed my remarks last year or were desperate for speakers this year. I prefer to believe the former -- but -- for whatever reason, this seems to be the start of a tradition of the Mint Director reporting first hand to the coin collectors, our valued customers, on the affairs and plans of the Mint.

For the benefit of those who missed last year's remarks let me take a moment and review my duties as Mint Director to provide a short introduction to the Nation's Mints.

One might think that a Mint Director, like the King in an old nursery rhyme, might spend all of her time in the "counting house, counting all the money". The job and the Mint are more complex than that.

The Mint Director wears many hats including those of a factory foreman, a policeman, an international diplomat and a marketer. However, the principle responsibilities are those of producing the Nation's coinage, around 18 billion last year, and the security of the gold reserves. As I am fond of saying, Elizabeth Taylor may have her diamond, but nothing can compare to my 263.5 million fine troy ounces of gold presently worth about 80 billion dollars.

Speaking as a factory foreman I should tell you that the Mint operates out of six facilities across the country, located in Denver, Philadelphia, West Point New York, two in San Francisco and, of course, Fort Knox. Philadelphia and Denver produce the bulk of our coinage. Our headquarters in Washington coordinates all of the work done in the field plus works directly with the Congress and other government agencies. In this past year, the Mint headquarters moved from a dilapidated old building on 13th Street to a new and modern building closer to the Capitol Hill area. The employees like the new surroundings and it is certainly a more functional work place than the old building.

As a policeman, I protect the gold reserves of the United States, substantial silver reserves, the coins in the mints and some unidentified items stored in our vaults by

other government agencies in the event of a national emergency. The Mint employs over 200 men and women as police officers to carry out this mission.

On the international scene we are the largest Mint in the world. We are also the only national mint administered by a woman. This past year we have received visitors from all around the globe who come to us seeking technical or marketing advice. Additionally, the U. S. Mint participated for the first time in many years in the FIDEM Congress in Stockholm, Sweden last June. This biennial conference brings together medalists, Mint Directors and artists to review and discuss trends in medal making and design. I found that Congress to be very educational on an art form few understand or appreciate.

In the Statue of Liberty program on which the Treasury is now embarking, the U. S. Mint is charged, among other things with developing our export program. It is my intent to model our efforts along the same line as the leading foreign mints in worldwide marketing and develop some inhouse expertise working with groups of established regional distributors abroad. It is an exciting venture and if successful, hopefully, will open new markets for all of the Mint products. For the convenience of U. S firms we have decided that the domestic market for the Statue of Liberty Program will include all of North, Central and South America.

The Mint manages an extensive marketing effort. In the past year, we sold 2.7 million 1985 proof sets, 1.9 million 1984 uncirculated sets plus national medals and assorted other coins. We operate three retail sales operations and have a contractor operate the fourth. The ANA is not the only convention at which the Mint had an exhibit. For the past three years we had exhibits at the major banking and financial conventions to introduce them to Mint products and we recently participated at the Canadian Numismatic Convention.

Our inhouse gold medallion sales effort last December and January resulted in the sales of 100,000 medallions worth $26 million.

Next month the Mint will issue its first catalogue of products in a special Christmas promotion. The catalogue will offer the regular proof and uncirculated coin sets plus Mint medals. Gold medallions will be available in sets of five ounce pieces or half ounce pieces. This will be the last time George Washington Commemorative Coins will be offered to the public. It is our plan to discontinue sales and melt the remaining coins at the start of next year. So, if you have not bought your GW coins, this is your last chance.

All of our marketing efforts are geared toward professionalizing our delivery and enchancing our products. Additionally, these programs are good revenue raisers for the government, having produced a $279 million contribution to the general fund of the Treasury last year. This does not include the $72 million dollars raised in the Olympic Coin Program for the U. S. Olympic effort. You see the U. S. Mint makes money in more ways than one.

As I mentioned, the Treasury Department through a joint effort by the Office of the Treasurer and the U. S. Mint is now embarking on a coin program, similar to the Olympics to raise funds for the restoration and renovation of the Statue of Liberty and Ellis Island. The program will feature three coins, a gold half eagle, a silver dollar and a clad fifty cent piece. They will carry a surcharge of $35, $7 and $2 respectively in the selling prices which are earmarked for the Foundation organizing the restoration effort. It is the goal of this program to raise at least $40 million to "help save the lady". The first coins will be struck during simultaneous ceremonies at the West Point Bullion Depository and the San Francisco Assay Office in October. The first public offering of the coins will be made in November with delivery slated for the first of the year. A great deal of effort has gone into the many facets of this program and we certainly have built on our Olympic experience to design a tremendous coin program.

All through the Olympic Program we had major problems with order processing, computer processing and customer service. I spent many anguishing afternoons signing letters to outraged customers who had not received their coins or had not had their problem resolved to their satisfaction. Recognizing that good customer service is a company's key to excellence, we are making major improvements.

When I first came to the Mint I regarded Computers as somewhat similar to witchcraft. Today, while I am by far not an expert, there is a deep, deep appreciation for what a good computer can do for you or what a bad set up can do to you. The Mint's old computer has been replaced with a modern reliable group of minicomputers which will provide more efficient and accurate processing. Our former computer was in such bad shape that midway through the Olympic program we had to transfer to another computer resulting in terrible transfer problems. We are upgrading the software that manages the Mint mailing list to provide ease of access to a customer's account and more flexibility. We will be able to accept such simple information as a four line address, telephone numbers and a more accurate history of purchases. The system will also have an inquiry tracking system. So if you do write us with a problem, your letter will be monitored from receipt to resolution. Finally, instead of being listed on our accounts , for instance, as D. Pope, I can, if I wish,

be listed as Mrs. Donna Pope.

We are moving the customer service center out of the San Francisco Old Mint to a new modern facility in suburban Washington. The tremendous distance between coasts made it nearly impossible to manage this function and respond to the changing conditions found in a special coin program. Being closer will allow senior supervisors to manage more closely the important customer service function. So, don't be surprised to see a Washington return address on your letters.

The Mint is already using the private sector for the actual order processing system. We are presently using the services of Mellon Bank to process the bulk of all the orders though a lock box. The Mint's order processing equipment was almost antique and could not adjunct to the demands of special coin programs. The lock box permits speedier processing so that funds are deposited faster resulting in greater interest collection for the government.

The change with which most of you are probably already familiar is the switching from sending all parcels by registered mail to using a combination of first class mail, UPS delivery and registered mail for silver and gold coins. It was just too expensive to send a proof set by registered mail. Switching to UPS for shipment of 3, 4, and 5 proof sets saves $380,000 over first class mail and $3,500,000 over registered mail. These savings are what allow us to sell, one of, if not the most inexpensive proof set in the world.

Few serious problems have been reported by the UPS delivery. On the first trial we did send sets to home address instead to the Post Office boxes listed on the mailing list. This caused a concern among some collectors who use a post office box to protect their coin collection. One irate man telephoned rather upset because until the proof set notice arrived at home, his wife was not aware that he had a post office box. Not wanting to be the contributing factor in family problems we have separated all the customers with Post Office boxes and make sure their coins are sent to those boxes. A key thing I'd like you to remember is that UPS will pay for the replacement of any coin set that is stolen or damaged so our customers are protected. And during our cost benefit analysis we determined that even with our first class mail replacements, there would be a great cost savings.

I think this pretty much updates you on the numismatic side of the Mint.

Our expansion and improvement project at the Denver Mint is moving along quite well with construction expected to be finished by January. We are testing some high speed coin

presses and mintwide we are working with a group of efficiency engineers to develop work standards and guides for our production process. I was amazed to learn, when I became Mint Director, that engineered standards for our plants did not exist. Any modern manufacturing plant has such standards and in the near future so shall the Mint.

As you see the Mint has been a busy place this past year and I have every reason to believe we will be just as busy in the next year. It is certainly a challenge to come from the outside to help a President carry out his program. I have always viewed my responsibility as a member of this Administration to find ways to carry out the Mint's mission in an inexpensive and efficient manner.

President Reagan has said that a government agency is the closest thing to eternal life found on the earth. The spending habits of the government resembles that of the feeding habits of a new born baby. An alimentary canal with an insatiable appetite at one end and no sense of responsibility at the other.

I am proud that at the U.S. Mint we have achieved a measure of success in reducing that appetite and restoring responsibility. Formerly, at the end of the budget year in Washington it was not uncommon to see an agency rush out and buy all sorts of unneeded supplies because the agency discovered they were not going to need all of their budget for planned expenses. I am pleased to report that at the end of last year when we discovered we were running a $7.5 million surplus at the end of the year, I returned that money to the general fund of the Treasury. That is the kind of responsibility in government the public demands, and the kind we in the Reagan Administration want to deliver, and with the help of the people at the Mint we work daily for that deliverance

In closing, I hope all of you found time this past week to visit the U. S. Mint exhibit. A lot of planning went into this year's exhibit since we wanted to have a good sales effort and make it educational. This is the first time we have had some of the regular engraving staff out in the public showing their work and explaining the process. I want to thank the organizers of this theatre and the American Numismatic Association for their hospitality. It has been a pleasure to be here this afternoon, and if you let me "coin a phrase" I hope the coin business continues to thrive in "Mint" condition.

I;ll be glad to take ten minutes of friendly questions.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
September 23, 1985

CONTACT: Art Siddon
566-5252

DAVID V. DUKES SELECTED
EXECUTIVE DIRECTOR
OF THE JOINT FINANCIAL MANAGEMENT IMPROVEMENT PROGRAM

Treasury Secretary James A. Baker, III, in his capacity as Chairman of the Joint Financial Management Improvement Program (JFMIP), today announced the selection of David V. Dukes to be the Program's new Executive Director.

The JFMIP is a joint and cooperative undertaking of the Department of the Treasury, the Office of Management and Budget, the General Accounting Office, and the Office of Personnel Management, working in cooperation with each other and with operating agencies to improve financial management practices. Leadership and guidance are provided by the four Principals of the Program -- the Secretary of the Treasury, the Director of the Office of Management and Budget, the Comptroller General of the United States, and the Director of the Office of Personnel Management. Under the guidance of a Steering Committee, the Executive Director and his staff develop, direct and undertake projects that contribute significantly to the efficient and effective planning and operation of government financial programs.

Mr. Dukes formerly was Deputy Assistant Secretary, Finance, with the Department of Health and Human Services. In that capacity he was responsible for the Department's accounting, fiscal, and budget execution policies; for development and improvement of Department-wide financial systems; and for the operation of major financial systems. He has also held financial and auditing positions with other government agencies and the private sector.

Mr. Dukes graduated Magna Cum Laude with a degree in accounting from Husson College in Bangor, Maine, and earned a Masters Degree in Public Administration from the University of Washington at Seattle. He has received various Departmental awards and is a member of the Association of Government Accountants.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-204

FOR IMMEDIATE RELEASE

September 23, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $4,514 million of 13-week bills and for $4,503 million of 26-week bills, both to be issued on September 26, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing December 26, 1985			26-week bills maturing March 27, 1986		
	Discount Rate	Investment Rate 1/	Price	Discount Rate	Investment Rate 1/	Price
Low	6.71%a/	6.92%	98.304	7.00%b/	7.36%	96.461
High	6.85%	7.07%	98.268	7.08%	7.44%	96.421
Average	6.81%	7.02%	98.279	7.05%	7.41%	96.436

a/ Excepting 1 tender of $1,000,000.
b/ Excepting 1 tender of $1,000,000.

Tenders at the high discount rate for the 13-week bills were allotted 9%.
Tenders at the high discount rate for the 26-week bills were allotted 34%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	Received	Accepted
Boston	$ 90,625	$ 51,525	$ 85,110	$ 48,510
New York	14,773,620	3,375,065	14,876,455	3,405,955
Philadelphia	23,180	23,180	24,585	24,585
Cleveland	52,965	52,965	37,640	37,640
Richmond	136,375	136,375	78,510	78,510
Atlanta	44,045	44,045	44,550	43,050
Chicago	1,212,245	230,060	966,440	128,140
St. Louis	28,950	28,950	29,810	29,810
Minneapolis	65,545	65,545	40,525	40,525
Kansas City	50,010	50,010	51,715	51,715
Dallas	46,905	46,905	34,180	34,180
San Francisco	2,432,390	141,390	2,173,200	188,200
Treasury	268,375	268,375	391,815	391,815
TOTALS	$19,225,230	$4,514,390	$18,834,535	$4,502,635
Type				
Competitive	$16,670,365	$1,959,525	$15,862,705	$1,530,805
Noncompetitive	1,024,715	1,024,715	1,083,530	1,083,530
Subtotal, Public	$17,695,080	$2,984,240	$16,946,235	$2,614,335
Federal Reserve	1,389,450	1,389,450	1,400,000	1,400,000
Foreign Official Institutions	140,700	140,700	488,300	488,300
TOTALS	$19,225,230	$4,514,390	$18,834,535	$4,502,635

1/ Equivalent coupon-issue yield.

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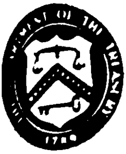

THE SECRETARY OF THE TREASURY
WASHINGTON

FOR IMMEDIATE RELEASE SEPTEMBER 22, 1985

Following is a list of participants in the meeting with industrial country Finance Ministers, Central Bank Governors, and Deputy Finance Ministers at the Plaza Hotel in New York City, Sunday, September 22, 1985:

United States:	James A. Baker, III - Secretary of the Treasury Paul A. Volcker - Chairman, Federal Reserve Board of Governors Richard G. Darman - Deputy Secretary of the Treasury David C. Mulford - Assistant Secretary for International Affairs
United Kingdom:	Nigel Lawson - Chancellor of the Exchequer Robin Leigh-Pemberton - Governor, Bank of England Geoffrey Littler - Second Permanent Secretary, Treasury
Germany:	Gerhard Stoltenberg - Minister of Finance Karl Otto Poehl - President, Bundesbank Hans Tietmeyer - State Secretary of Finance
France:	Pierre Beregovoy - Minister of the Economy and Finance Michael Camdessus - Governor, Bank of France Daniel Lebegue - Director of the Treasury
Japan:	Noboru Takeshita - Minister of Finance Satoshi Sumita - Governor, Bank of Japan Tomomitsu Oba - Vice Minister of Finance for International Affairs

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE September 23, 1985

Treasury Appoints Executive Director
to African Development Bank

Treasury Secretary James A. Baker III today announced the appointment of Donald R. Sherk to serve as United States Executive Director to the African Development Bank.

Mr. Sherk will begin his new assignment in Abidjan, Ivory Coast, in early October.

Since June of 1982, Mr. Sherk has served as United States Alternate Director to the Manila-based Asian Development Bank and for approximately nine months of 1984 served as Acting Director to the ADB. Prior to his appointment to the Asian Development Bank, Mr. Sherk served as Deputy Director of the Office of Multilateral Development Banks in the Treasury Department. Before that, he served as Senior Economist for Bank Policy and Asian Development Bank Desk Officer in the same Treasury Department office.

Prior to joining the Treasury Department in 1977, he was a chairman of the economics department at Simmons College in Boston and had also taught economics at the University of Iowa and the U.S. Military Academy at West Point.

Mr. Sherk, 49, was born in Ida Grove, Iowa. He received B.A., M.A. and Ph.D. degrees from the University of Iowa. Mr. Sherk is married and has two sons and a daughter.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR RELEASE AT 4:00 P.M.

September 24, 1985

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $13,600 million, to be issued October 3, 1985. This offering will not provide new cash for the Treasury, as the maturing bills are outstanding in the amount of $13,604 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239, prior to 1:00 p.m., Eastern Daylight Saving time, Monday, September 30, 1985. The two series offered are as follows:

91-day bills (to maturity date) for approximately $6,800 million, representing an additional amount of bills dated July 5, 1985, and to mature January 2, 1986 (CUSIP No. 912794 JL 9), currently outstanding in the amount of $7,070 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $6,800 million, to be dated October 3, 1985, and to mature April 3, 1986 (CUSIP No. 912794 JZ 8).

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.

The bills will be issued for cash and in exchange for Treasury bills maturing October 3, 1985. In addition to the maturing 13-week and 26-week bills, there are $8,311 million of maturing 52-week bills. The disposition of this latter amount was announced last week. Tenders from Federal Reserve Banks for their own account and as agents for foreign and international monetary authorities will be accepted at the weighted average bank discount rates 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. For purposes of determining such additional amounts, foreign and international monetary authorities are considered to hold $1,463 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $1,538 million as agents for foreign and international monetary authorities, and $5,370 million for their own account. These amounts represent the combined holdings of such accounts for the three issues of maturing bills. Tenders for bills to be maintained on the book-entry records of the Department of the Treasury should be submitted on Form PD 4632-2 (for 26-week series) or Form PD 4632-3 (for 13-week series).

Each tender must state the par amount of bills bid for, which must be a minimum of $10,000. Tenders over $10,000 must be in multiples of $5,000. Competitive tenders must also show the yield desired, expressed on a bank discount rate basis with two decimals, e.g., 7.15%. Fractions may not be used. A single bidder, as defined in Treasury's single bidder guidelines, shall not submit noncompetitive tenders totaling more than $1,000,000.

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 as of 12:30 p.m. Eastern time on the day of 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.

A noncompetitive bidder may not have entered into an agreement, nor make an agreement to purchase or sell or otherwise dispose of any noncompetitive awards of this issue being auctioned prior to the designated closing time for receipt of tenders.

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 yield 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 $1,000,000 or less without stated yield from any one bidder will be accepted in full at the weighted average bank discount rate (in two decimals) of accepted competitive bids for the respective issues. The calculation of purchase prices for accepted bids will be carried to three decimal places on the basis of price per hundred, e.g., 99.923, and the determinations of the Secretary of the Treasury shall be final.

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 the issue date, in cash or other immediately-available funds or in Treasury bills maturing on that date. 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. In addition, Treasury Tax and Loan Note Option Depositaries may make payment for allotments of bills for their own accounts and for account of customers by credit to their Treasury Tax and Loan Note Accounts on the settlement date.

In general, if a bill is purchased at issue after July 18, 1984, and held to maturity, the amount of discount is reportable as ordinary income in the Federal income tax return of the owner at the time of redemption. Accrual-basis taxpayers, banks, and other persons designated in section 1281 of the Internal Revenue Code must include in income the portion of the discount for the period during the taxable year such holder held the bill. If the bill is sold or otherwise disposed of before maturity, the portion of the gain equal to the accrued discount will be treated as ordinary income. Any excess may be treated as capital gain.

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

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE September 26, 1985

RESULTS OF TREASURY'S 52-WEEK BILL AUCTION

Tenders for $8,305 million of 52-week bills to be issued October 3, 1985, and to mature October 2, 1986, were accepted today. The details are as follows:

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate (Equivalent Coupon-Issue Yield)	Price
Low -	7.32%	7.86%	92.599
High -	7.35%	7.90%	92.568
Average -	7.33%	7.87%	92.589

Tenders at the high discount rate were allotted 52%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted
Boston	$ 76,895	$ 31,895
New York	15,574,690	7,527,690
Philadelphia	6,940	6,940
Cleveland	110,900	110,900
Richmond	36,800	24,400
Atlanta	22,845	18,045
Chicago	1,227,955	286,195
St. Louis	78,920	36,920
Minneapolis	6,990	6,990
Kansas City	14,335	14,335
Dallas	14,670	4,670
San Francisco	1,174,125	143,765
Treasury	92,025	92,025
TOTALS	$18,438,090	$8,304,770
Type		
Competitive	$16,014,150	$5,880,830
Noncompetitive	348,940	348,940
Subtotal, Public	$16,363,090	$6,229,770
Federal Reserve	2,000,000	2,000,000
Foreign Official Institutions	75,000	75,000
TOTALS	$18,438,090	$8,304,770

An additional $100,000 thousand of the bills will be issued to foreign official institutions for new cash.

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TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE
Sept. 27, 1985

Contact: Bob Levine
(202) 566-2041

TREASURY SUBMITS TIED AID CREDIT LEGISLATION

In accordance with the President's trade strategy for the eighties, Secretary Baker announced today that he has transmitted to Congress proposed legislation to establish a $300 million tied aid credit fund. This action is consistent with the President's commitment announced in his speech of September 23, 1985.

Secretary Baker said, "The use of tied aid credits for commercial purposes by other governments is an unfair trade practice that has lost markets for U.S. businesses. It cannot be allowed to continue. We will direct these funds at those few countries that are blocking an agreement to eliminate these predatory practices."

Tied aid and partially untied aid credits, which are aid funds alone or in combination with official export credits, are offered by other governments at low levels of concessionality to win commercial sales. They are, in effect, subsidies that deprive U.S. companies of fair access to world markets and undermine the existing agreement to limit export credit subsidies. These practices also impede the growth of developing countries by diverting funds away from development needs.

The proposed legislation would create a $300 million temporary tied aid fund in the Treasury Department which would provide grants combined with Export-Import Bank and/or private credits. These tied aid credits would be targeted at the export markets of those countries which engage in such tied aid and partially untied aid credits and which block progress toward an agreement to restrict these predatory practices. This facility could support up to $1.0 billion in tied aid credit authorizations.

The Administration has proposed to the 22 industrial countries of the Organization for Economic Cooperation and Development that at least 50 percent of any such credit be in the form of a grant. That minimum grant element would make these credits so expensive to use that in practice they would be limited to foreign aid. At the last OECD Ministerial, the United States succeeded in reaching agreement to raise the minimum grant element from 20 to 25 percent, but further progress toward imposing greater discipline over tied aid credits was blocked by a few key countries. Most other OECD members agree that the minimum grant element should be increased.

TREASURY NEWS

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STATEMENT OF
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ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TAXATION AND DEBT MANAGEMENT
OF THE
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Subcommittee:

I am pleased to appear before you today to present the views of the Treasury Department on a report, prepared by the Staff of this Committee, entitled "The Subchapter C Revision Act of 1985." This report, issued in May 1985, contains a set of specific recommendations to make a series of changes to Subchapter C of the Internal Revenue Code. The Treasury Department is interested in and supportive of the effort to reform the current rules applicable to the taxation of corporations and their shareholders, and we applaud the Staff for its excellent work in preparing a comprehensive set of proposals, reduced to statutory language and accompanied by rich explanatory material, to reform and to simplify this area.

We are concerned, however, that enactment of changes of the magnitude suggested by the Staff is for several reasons inappropriate at this time. First, in light of the substantial modifications to the Internal Revenue Code that will be necessary to accomplish fundamental tax reform, we are hesitant to support further extensive changes. Second, the Treasury Department does not believe that the potential economic effects of the Staff's far-reaching proposals have been adequately considered. In this regard, we complement the Committee for soliciting the views of various economists for today's hearing, but we must emphasize that before undertaking major changes in an area as well settled

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as Subchapter C, these potential effects must be clearly understood. Therefore, with one important exception discussed below, we recommend that the Committee defer passage of extensive changes to Subchapter C until fundamental tax reform has been completed, the resulting statutory changes have become understood by taxpayers and their advisors, and the potential economic effects of the Staff proposals have been more thoroughly documented.

Despite our view that extensive changes to Subchapter C are inappropriate at this time, we believe that serious attention should be devoted this year to the limitations imposed by the Internal Revenue Code on the extent to which a corporation can utilize net operating loss carryovers, excess tax credits, and other tax attributes following certain corporate transactions. The existing limitations were amended extensively by the Tax Reform Act of 1976 ("1976 Act"), but the effective dates of those amendments have been delayed repeatedly in response to criticism and are currently scheduled to become effective on January 1, 1986.

Unlike the proposed Subchapter C changes generally, the limitations on the carry over of net operating losses and other tax attributes have been considered extensively by Congress and the Treasury Department during the past several years. There is general consensus that the existing limitations are wholly inadequate and in need of revision, and that the 1976 Act amendments, which have been debated for almost ten years, also are seriously flawed. Accordingly, the Treasury Department believes that new rules to replace both the existing limitations and the 1976 Act amendments should be developed before January 1, 1986.

In general, the Treasury Department strongly supports the proposal regarding the limitations on net operating loss carryovers and other tax attributes included in the Staff Report. We believe the Staff proposal offers an excellent foundation on which to build a reformed system that can replace the current law and 1976 Act limitations on the utilization of carryovers. Consequently, although we will not at this time discuss the full range of modifications to Subchapter C suggested by the Staff, we will discuss in detail the proposed set of rules governing the extent to which net operating losses and other tax attributes may be utilized following corporate acquisitions.

Background

Under current law, a corporation that incurs a net operating loss in one year generally is permitted to use the loss to offset income earned in the three taxable years prior to and the 15 years after the year in which the loss is incurred. Similarly, a corporation that incurs a capital loss may generally use that

loss to offset income earned in the three years prior to and the five years after the year in which the loss is realized. The underlying premise of allowing a corporation to offset a loss incurred in one year against taxable income earned in another year is to provide an averaging device to ameliorate the unduly harsh consequences of a strict annual accounting system. For similar reasons, corporations that are unable to use all their credits against tax in the year in which the credits are earned generally may use such excess credits to offset tax liability in the three prior and 15 succeeding taxable years. Foreign tax credits, however, may be carried forward only five years.

The tax attributes of a corporation, including net operating loss carryovers, net capital loss carryovers, and excess credit carryovers, 1/ generally survive an acquisition of the corporation, because the corporation's tax history is not affected if its corporate status is unchanged. Thus, if a person purchases the stock of a corporation in a taxable stock acquisition, the corporation's tax attributes generally are preserved, unless the acquiring corporation makes a section 338 election. Thus, the ability to use the net operating loss carryovers of an acquired corporation to offset income earned by that corporation in the 15 years after the loss typically is not affected by the stock purchase. If a section 338 election is made, however, the taxable stock acquisition shares most of the characteristics of a taxable asset acquisition from a liquidating corporation, including the fact that the acquiring corporation does not succeed to any of the target corporation's tax attributes. In addition, if a corporation is acquired by another corporation in a tax-free acquisition, the Internal Revenue Code provides that the tax attributes of the target corporation carry over to the acquiring corporation, notwithstanding the fact that the acquired corporation's separate corporate existence may terminate. Finally, tax attributes similarly carry over in the case of a tax-free liquidation of an 80-percent-owned subsidiary.

Section 382 was added to the Internal Revenue Code in 1954 to establish objective tests that would curb "trafficking" in corporations with unused net operating losses. 2/ Congress was

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1/ The credits that are available for carry over include the various business credits, the research credit, and the foreign tax credit.

2/ A similar set of rules is provided in section 383 to limit the use of corporate tax attributes other than net operating losses, such as tax credit carryovers, foreign tax credit carryovers, and capital loss carryovers. For convenience, we will refer in our discussion primarily to net operating loss carryovers. Most of the same principles, however, apply to the other corporate tax attributes.

particularly concerned that profitable corporations were acquiring shell corporations whose principal asset was a net operating loss carryover that could be applied in future years against income unrelated to any business activity of the acquired corporation. 3/

In the Tax Reform Act of 1976, Congress sought to tighten and to unify the provisions of section 382. The 1976 Act amendments were enacted in part because Congress believed that section 382 as enacted in 1954 was ineffective and did not adequately serve its purpose. The effective dates of the 1976 Act amendments, however, have been delayed repeatedly in response to criticism, most recently in the Tax Reform Act of 1984, and are currently scheduled to become effective on January 1, 1986.

Section 382, both as presently in effect and as modified by the 1976 Act amendments, incorporates two sets of rules for limiting the utilization of net operating losses. One set of rules applies in cases of changes of ownership by taxable stock purchase or redemption and the other set of rules applies to acquisitions by tax-free reorganization.

3/ In addition to the objective limitations contained in sections 382 and 383, the carry over of net operating losses, capital losses, and credits may be disallowed under section 269 if the principal purpose of an acquisition of a corporation is tax avoidance by securing the benefit of the losses or excess credits. Thus, section 269 serves as a backstop to prevent misuse of the general carryover limitation provisions. In addition to these statutory limitations, the ability of an acquiring corporation to benefit from the tax attributes of a target corporation by joining with the target to file a consolidated income tax return is limited to some extent by the change of ownership and separate return limitation year rules provided in applicable Treasury regulations. The consolidated return regulations under certain circumstances also limit the ability to benefit from "built-in" losses following an acquisition. Finally, limitations also may be imposed under certain situations by operation of a judicially-crafted continuity of business enterprise test. In Libson Shops, Inc. v. Koehler, 353 U.S. 382 (1957), the Court held that net operating loss carryovers would not survive a statutory merger unless the losses were offset against income earned after the merger that was attributable to the same business that produced the loss. Libson Shops arose under the 1939 Code, but its applicability under existing law is unclear. The legislative history of the 1976 Act amendments to section 382, however, provides expressly that the continuity of business enterprise concept articulated in Libson Shops will not survive the effective date of those amendments.

<u>Purchase Rule</u>

Under existing section 382, in the case of redemptions and acquisitions by purchase, 4/ no carry over of net operating losses is permitted if (1) more than 50 percent of the stock of the corporation that incurred the loss ("loss corporation") changes ownership within two taxable years, 5/ and (2) the loss corporation does not continue to carry on substantially the same trade or business after the change in stock ownership. The determination of whether 50 percent of the loss corporation stock has changed ownership is made with reference to the ten largest shareholders. Thus, in a transaction in which loss corporation stock is sold or redeemed, the carry over of net operating losses is prohibited only if there is both (1) insufficient "continuity of interest" by the loss corporation's ten largest shareholders and (2) insufficient "continuity of business enterprise" after the transaction. If either of these conditions does not occur, however, the use of net operating loss carryovers following a stock purchase or a redemption is not subject to any limitations. Thus, for example, all the stock of a corporation may be sold without invoking any limitations under section 382 if the new owners continue the loss corporation's historic business. Therefore, assuming the inapplicability of the <u>Libson Shops</u> doctrine and section 269, the net operating loss carryovers may be used to offset income from new businesses.

The 1976 Act amendments tightened the limitations applicable to taxable acquisitions by removing the requirement that the historic trade or business of the loss corporation be terminated before limitations on carryovers would be imposed. Thus, under the 1976 Act amendments, the limitations would be triggered solely by reference to changes in stock ownership. 6/ Moreover, the 1976 Act amendments would have broadened the definition of

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4/ For purposes of section 382(a), the issuance of new stock does not constitute a "purchase." Thus, the acquisition of a control of a loss corporation through direct issuance of stock does not involve any limitations on the corporation's use of net operating loss carryovers.

5/ Changes of ownership among related persons are disregarded under section 382(a).

6/ The 1976 Act amendments changed the focus from voting stock that was not limited and preferred as to dividends to all "participating stock." In general, participating stock includes any stock that represents an interest in a corporation's earnings and assets that is not limited to a stated amount. This change was intended to prevent the use of "preferred" stock to circumvent the section 382 limitations.

purchase to include capital contributions that increase the percentage of stock owned by a shareholder. These amendments also raised the threshold change of stock ownership from 50 percent to 60 percent in the case of taxable stock purchases, increased to 15 the number of relevant shareholders, and lengthened the "lookback" period. The increase in the threshold from 50 percent to 60 percent was enacted to coordinate the rules applicable to purchases with those applicable to reorganizations, described below. In addition, rather than eliminating all net operating losses once the required change in stock ownership occurred, net operating loss carryovers under the 1976 Act amendments would be gradually phased out as the percentage change in stock ownership increases from 60 percent to 100 percent. Finally, although the 1976 Act amendments did not repeal section 269, the applicable legislative history provides that section 269 would not deny a deduction for a loss that survived section 382, in the absence of a scheme to circumvent the purpose of the limitations.

Reorganization Rule

Under section 382(b) as presently in effect, the carry over of net operating losses generally is limited in the case of certain tax-free reorganizations if the stock in the acquiring corporation that is received by shareholders of the loss corporation after the acquisition represents less than 20 percent of the stock of the surviving corporation. In such a case, the net operating loss carryovers of the loss corporation are gradually reduced based upon the level of the loss corporation shareholders' ownership in the surviving corporation. In particular, for each percentage point below 20 percent received by loss corporation shareholders, the amount of net operating loss carryovers that survive the reorganization is reduced by five percent. It is irrelevant for purposes of the reorganization rule whether the acquiring corporation continues to conduct the trade or business of the loss corporation. Thus, assuming that neither section 269 nor Libson Shops is applicable, the net operating loss carryovers fully survive if the loss corporation shareholders receive at least 20 percent of the acquiring corporation's stock.

Under the 1976 Act amendments, the types of tax-free reorganizations to which section 382 applies would have been expanded significantly to prevent avoidance of the limitation. 7/ This expansion sought to cure one of the most glaring deficiencies in the current limitations. The limitations applicable to tax-free reorganizations would have been strengthened further by increasing from 20 percent to 40 percent the level of stock ownership at which net operating loss

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7/ Under existing section 382, the otherwise applicable statutory limitations may be effectively avoided by using either triangular or stock-for-stock reorganizations.

carryovers would be limited. Thus, the shareholders of a loss corporation would be required to receive at least 40 percent of the acquiring corporation's stock for the net operating losses to be allowed in full. If, on the other hand, the loss corporation's shareholders acquired less than 40 percent of the stock of the acquiring corporation in such a tax-free reorganization, the net operating losses available to the acquiring corporation would be phased out as the loss corporation shareholders' percentage ownership in the surviving corporation declined. As in the case of taxable purchases and redemptions, the limitations applicable to tax-free reorganizations under the 1976 Act amendments would turn solely on changes in stock ownership.

Discussion

Before discussing the Staff's proposal to change the applicable limitations, it is useful to outline briefly the theoretical underpinnings of limitations on the carry over of net operating losses and other tax attributes following the acquisition of a corporation. We also will describe generally the criticism that has been made in response to existing law and the 1976 Act amendments.

Basic Principles

In analyzing the issues raised by the carry over of corporate net operating losses, commentators have suggested the following competing, and somewhat inconsistent, tax and economic policy considerations:

- any rule governing the carry over of tax attributes should be consistent with the historic legislative purpose of the carryover provisions as averaging devices;

- the tax laws should not distort investment decisions and should not create undue bias between diversified and non-diversified entities or between old and new businesses;

- a corporation's ability to carry over net operating losses should not require the Federal Government to be a partner in all businesses. In other words, the rules governing the use of net operating losses should not amount to a Federal subsidy for all such losses;

- the rules applicable to the carry over of tax attributes should prevent "trafficking" in loss corporations;

- the limitations on the carry over of net operating losses and other tax attributes should not result in tax attributes of a corporation becoming more or less valuable in the hands of a purchaser of the corporation than they would have been in the hands of the seller;

the tax laws should not encourage corporate acquisitions that would not be undertaken on purely economic grounds or discourage those that would be undertaken on such grounds; and

the rules establishing limitations on carryovers also should provide certainty in determining the extent to which tax attributes will survive an acquisition to prevent a purchaser from obtaining a windfall from the carryover.

Refundability

As is apparent from these principles, the initial question that must be faced is whether any limitations should be imposed on the use of net operating loss carryovers. One can argue that the rules governing the use of net operating losses will not create a bias among various types of entities and businesses and will not distort investment decisions only if all limitations are removed from the utilization of such losses. The furthest move in this direction would be to provide for refundability of net operating losses. In a refundability system, a corporation that incurred a net operating loss would receive a refund from the Federal government equal to the tax savings that would have resulted if the corporation had been able to offset fully the net operating loss in the year incurred against other income.

A provision for direct reimbursement of net operating losses by the Federal government would, of course, eliminate the need for limitation provisions such as section 382. Moreover, such a system would ensure that the benefits of a net operating loss would accrue directly to the entity that suffered the loss.

The adoption of a refundability system also would eliminate the current bias in favor of conglomeration that exists with respect to the deductibility of net operating losses. This bias exists because net operating losses of one business may be offset against profits of another business, thereby reducing the conglomerate's current tax burden. By comparison, a corporation engaged in a single line of business does not receive any tax benefit from a net operating loss until and unless the corporation realizes offsetting income. On a present value basis, such a net operating loss is worth less than a net operating loss that is usable currently. A reimbursement system would eliminate this bias by providing the same after-tax consequences for a net operating loss regardless of the existence of a related profitable enterprise.

Similarly, the current treatment of net operating losses is biased with respect to new investment in favor of established enterprises. An established corporation that incurs a loss on an investment may secure an immediate refund under current law by

applying that loss against past taxable profits. A new corporation, in contrast, is unable to utilize a net operating loss until it realizes taxable income. A system of refundability would eliminate this bias by equalizing the tax benefits of losses between new and existing businesses.

While a system of refundability might well make the net operating loss provisions more neutral among various types of enterprises, the Treasury Department does not believe it is advisable to implement such a system. A system of refundability would require the Federal government to become a partner in all investments, a role we believe is inappropriate. Moreover, a system of refundability would pose potentially insurmountable administrative and budgetary problems. For example, verification of the bona fide value of the net operating losses would be imperative, yet extremely difficult and complex.

Free Trafficking

Short of providing direct government reimbursement of net operating losses, one can argue that all limitations on the carry over of tax attributes from one corporation to another, including section 382, should be repealed. Under such a system, profitable corporations would be free to purchase net operating losses from loss corporations. While this free trafficking in corporations with favorable tax attributes would not achieve complete neutrality, it would ensure that most of the benefit of the net operating losses would be realized by those who suffered the economic losses. Consequently, purchasers of loss corporations would not be able to realize profits at the expense of loss corporations or their shareholders.

Unrestricted trafficking in loss corporations, however, would constitute partial and indirect reimbursement of losses. As stated above, we do not believe that the carryover rules were intended to serve the function of providing Federal subsidies, whether direct or indirect, for corporate losses.

We also believe that unrestricted trafficking in loss corporations would go far beyond the legislative purpose underlying a corporation's right to offset a net operating loss incurred in one year against taxable income earned in another year. This right is intended merely as an averaging device to reduce the inequity of a strict annual accounting system.

Although we recognize that both refundability and the unrestricted trafficking in loss corporations might make risk-taking in corporate form more attractive, it is not clear that risk-taking is relatively discouraged under existing tax rules. The unrestricted ability to use corporate tax attributes, including net operating losses, also would encourage the takeover of loss corporations by profitable corporations primarily to obtain the tax benefits of net operating loss carryovers. Purely tax-motivated mergers and acquisitions would have adverse effects on the economy and should not be encouraged.

Alternate Bases For Limitations

Accepting, as we do, that it is appropriate to place some limitations on the carry over of net operating loss carryovers following corporate acquisitions, it is necessary to examine both the triggering events that make any limitations operative and the mechanics of the limitation. The principal triggering events that have been used in the past are continuity of shareholder interest and continuity of business enterprise. The limitation has always taken the form of complete disallowance or partial reduction of the amount of net operating loss carryovers that survive the triggering events.

For purposes of section 382, continuity of shareholder interest may be defined as the continued economic interest of the shareholders of the loss corporation in that corporation or its successor during the taxable years subsequent to the years in which the net operating losses were incurred. Since its enactment in 1954, section 382 has considered continuity of shareholder interest a significant factor in determining whether, and the extent to which, the carry over of net operating losses should be limited. The 1976 Act amendments to section 382, in the furthest move in this direction, established continuity of shareholder interest as the sole factor to be considered in determining the limitation on net operating loss carryovers following a change in ownership of the loss corporation.

The rationale for using continuity of shareholder interest as the basis for limiting carryovers is that a corporation's shareholders generally are the real parties who suffer economic loss when the corporation they own incurs a net operating loss. Thus, a net operating loss carryover should be deductible by the corporation only if such a deduction will reduce the shareholders' economic loss.

We believe that reliance on continuity of shareholder interest as a determinative factor for determining the extent to which carryovers survive a corporate acquisition, particularly as the sole factor as set forth in the 1976 Act amendments, is flawed for several reasons. First, a limitation based on continuity of shareholder interest may be inconsistent with the income averaging function of the net operating loss carryover provisions. For example, net operating losses under current law may result from a corporation's ability to deduct expenses prior to the year in which corresponding items of income must be reported. This mismatching of income and expenses most frequently occurs in the case of assets that are subject to the accelerated cost recovery system. To the extent that net operating losses result from this mismatching of expenses and income, rather than from economic losses, the lack of continuity of shareholder interest should not unduly restrict the ability of the business to use its net operating losses to offset income in subsequent taxable years.

Moreover, a loss limitation rule that reduces available net operating losses by reference to a specified percentage of continued shareholder interest, such as the reorganization rule in existing law and both rules under the 1976 Act amendments, may create undesirable economic effects. For example, if shareholders of the loss corporation are required to own a minimum percentage of the stock of the surviving corporation following a tax-free reorganization, then acquisitions by relatively large corporations are discouraged. In particular, the larger corporations would be denied the use of otherwise available net operating loss carryovers, and would thus be economically motivated to offer less consideration for the loss corporation than would a smaller potential acquirer. Certain acquisitions might thus be discouraged, even though desirable without regard to tax considerations. We do not believe that the limitations on the use of net operating loss carryovers should bias acquisitions in favor of smaller companies or penalize larger companies.

The second criterion upon which the limitation on the carry over of net operating losses has been based is continuity of business enterprise. Under the continuity of business enterprise test, limitations on the carry over of net operating losses are triggered if the business previously conducted by the loss corporation is not continued by the acquiring corporation. This approach is intended to restrict use of net operating loss carryovers to the business activities that produced the losses.

Using the continuity of business enterprise doctrine as a test to determine the availability of net operating loss carryovers also suffers several serious flaws. First, the continuity of business enterprise test is difficult to apply whenever significant new capital or other assets are added to the old business, or where the old business is operated in a different manner. This uncertainty has resulted in costly and time-consuming litigation without clarifying the ambiguous nature of the standard. In addition, it has caused purchasers of loss corporations to reduce the price they pay and gives them an opportunity to realize a profit at the expense of the loss corporation and its shareholders. Thus, the intended beneficiaries of the carryover provisions, those who suffered the loss, do not properly benefit from the carry over of the net operating losses by the acquiring corporation.

Second, using continuity of business enterprise as a triggering event for limitations on the utilization of net operating loss carryovers encourages a loss corporation, or a corporation that purchases a loss corporation, to continue operating an unprofitable business. Such uneconomic behavior should not be encouraged by the tax laws.

Third, even if the continuity of business enterprise test is met, the continuing business may be an insignificant part of the surviving corporation or produce no income, yet the net operating losses incurred prior to an acquisition in some cases can be used in full to offset income from other activities. Such a result, which in the extreme will be tantamount to free transferability of net operating losses, is unsatisfactory.

Criticism of Existing Law and the 1976 Act Amendments

The existing rules of section 382, which rely on both continuity of business enterprise and continuity of shareholder interest, suffer the same defects as their theoretical underpinnings. Moreover, we believe that existing law is deficient because many corporate acquisitions can be structured to avoid the application of the limitations in situations in which there may be no substantial business purpose other than utilization of the net operating loss of the acquired corporation. For example, the limitations imposed by section 382 do not apply to stock acquisitions described in section 368(a)(1)(B). The limitations also may be avoided by acquiring control of a corporation through the use of a subsidiary in a triangular reorganization. While section 269 and the consolidated return regulations may curtail such acquisitions under certain circumstances, existing section 382 inadequately serves its purpose when its provisions can be so easily avoided.

Finally, existing law is subject to deserved criticism because of its inconsistent treatment of acquisitions by taxable stock purchase and tax-free reorganization. For example, net operating loss carryovers are ratably disallowed in the wake of a tax-free reorganization in which there is insufficient continuity of shareholder interest, while the carryovers would be disallowed entirely if a purchase failed the requisite continuity of shareholder interest (assuming the historic business is not continued). In addition, section 382 distinquishes between purchase and reorganization transactions by applying the continuity of business enterprise test only to purchase transactions. Finally, the applicable thresholds on changes in ownership differ depending upon the type of transaction. We believe that the limitation on the use of net operating loss carryovers following purchases and reorganizations, which are often economically equivalent transactions, should be consistent.

The 1976 Act, in an attempt to create a more effective set of rules, eliminated the continuity of business enterprise requirement, coordinated the treatment of acquisitions by purchase and tax-free reorganization, and tightened the rules to prevent avoidance. While the rules enacted in 1976 addressed many of the principal defects of existing law, they have been criticized for their complexity. While complexity in the tax laws should be avoided whenever possible, it is justified if the

rules are necessary, theoretically correct, and effective. We believe, however, for the reasons stated above, that reliance on continuity of shareholder interest to measure the extent to which net operating loss carryovers may be used following an acquisition is neither necessary nor theoretically correct.

Description of the Staff Proposals

Preliminary Staff Report

A Preliminary Report released by the Staff of this Committee in September 1983 ("Preliminary Staff Report"), like existing law and the 1976 Act amendments, proposed two sets of rules, one for purchase transactions and a second for certain tax-free reorganizations. The mechanics of the proposal, however, were quite different from current law or the 1976 Act amendments.

The purchase rule provided in general that net operating loss carryovers of the loss corporation would be limited, as to both timing and amount, to the income the loss corporation would have earned had no change of ownership occurred and had the loss corporation begun to earn taxable income at an assumed rate of return on the assets it owned at the time the loss was generated. This rule would apply whenever the ownership of the outstanding stock of a corporation changes hands in a taxable purchase after a year in which the corporation incurred a loss.

Under the proposal, no limitations on net operating loss carryovers would be imposed unless more than 50 percent of the outstanding stock changed ownership after a loss year. In determining whether changes in the corporation's ownership were sufficient to invoke the rule, only shareholders who owned five percent or more of such stock in the carryover year, directly or by attribution, would be considered.

If 100 percent of the stock of a corporation were purchased, the purchase rule would limit the deduction of net operating loss carryovers for each subsequent taxable year to an amount equal to an assumed rate of return times the purchase price of the stock. The proposal specified that the assumed rate of return would be an after-tax rate to reflect the fact that the consideration paid for the stock of the loss corporation would generally cover the value of the assets as well as the net operating loss carryovers. The proposal suggested that the assumed rate of return might be an objective rate, such as 125 percent, of the fluctuating interest rate determined semi-annually pursuant to section 6621.

If more than 50 percent but less than 100 percent of the loss corporation's stock were purchased, the portion of the acquiring corporation's income attributable to the stock that had not been sold could absorb net operating loss carryover deductions with-

out limitation. The remaining portion of the earnings, attributable to the stock that had been purchased, could be offset only in an amount equal to the assumed return on the purchase price of that stock.

Under the Preliminary Staff Report, a separate set of rules would apply to any case in which the stock or assets of a loss corporation were acquired in a tax-free reorganization, for stock of the acquiring corporation, or for stock of a corporation that controls the acquiring corporation. Under the merger rule, the net operating loss carryovers otherwise available would be allowed to offset only the portion of income earned by the surviving corporation after the acquisition that is allocable to the contribution of the loss corporation's assets to the acquiring corporation. This merger rule was intended in principle to permit the use of net operating loss carryovers to the same extent that such carryovers would have been allowed if the loss corporation and the acquiring corporation had contributed all of their assets to a joint venture. The proposal attempted to duplicate the fact that, under such circumstances, only the portion of the joint venture's income allocable to the loss corporation could be offset by that corporation's net operating loss carryover.

After a tax-free reorganization, the merger rule would provide that the portion of the post-acquisition taxable income of the surviving corporation and its subsidiaries allocable to the loss corporation's assets would be determined by reference to the percentage of common stock of the acquiring corporation issued in the acquisition to the loss corporation's shareholders. The percentage of the acquiring corporation's taxable income that could be offset, however, would be less than the percentage of stock of the acquiring corporation issued to the loss corporation shareholders in the acquisition. The reduction was considered necessary because post-reorganization taxable income theoretically allocable to the loss corporation would not be subject to tax to the extent of allowable net operating loss carryovers. As a result, the percentage of the acquiring corporation's stock that would be issued in the acquisition generally would exceed the percentage of taxable income of the acquiring corporation allocable to the loss corporation's assets.

If an acquiring corporation issued stock and paid other consideration in a tax-free reorganization, the proposal contemplates that both the purchase rule and merger rule would apply. Thus, the surviving corporation would be able to utilize net operating loss carryovers in an amount equal to the sum of (i) the value of the other consideration times the applicable rate of return plus (ii) the portion of the surviving corporation's income that is allocable to the stock issued to the loss corporation shareholders.

Final Staff Report

Overview

Unlike the Preliminary Staff Report, the bill included in the Final Staff Report proposes a single rule that would limit the utilization of net operating loss carryovers and other tax attributes following a substantial change of ownership by either taxable purchase or tax-free reorganization. The basic principle of this approach, like the theory underlying both the purchase rule and merger rule suggested in the Preliminary Staff Report, is that the entire net operating loss carryover should be preserved following an ownership change, but a limit should be imposed on the amount of annual income against which the net operating losses can be deducted following the acquisition. In this manner, the Staff proposals attempt to ensure that the use of carryovers after an ownership change is limited to the use that would have been available to the loss corporation had no ownership change occurred and that the value of net operating loss carryovers is therefore neither increased nor decreased as a result of an acquisition. The bill provides in particular that the deductibility of net operating loss carryovers following a substantial ownership change would be limited in each year to an amount equal to the Federal long-term rate times the value of the loss corporation at the time of the ownership change. In general, a substantial change of ownership would be defined as any change, however accomplished, resulting in a greater than 50-percent shift in the ownership of the corporation's equity.

Losses Subject to Limitation

Following a substantial change in the ownership of a corporation, the Staff bill would generally limit the utilization of all net operating losses, capital losses, and credits incurred by the corporation prior to the ownership change. For this purpose, any net operating loss incurred in a taxable year during which a substantial change in ownership occurs would be allocated to the periods before and after the change on a pro rata basis. The bill also would generally limit the utilization of any "built-in loss" on the same basis as net operating losses. The treatment of built-in losses is discussed below in greater detail.

Amount of Annual Limitation

The utilization of net operating losses and other tax attributes in any post-change year would generally be limited by the Staff bill to the product of the value of the loss

corporation 8/ immediately before the ownership change multiplied by the applicable Federal long-term rate on the date of the change in ownership. The long-term rate was selected by the Staff because it represents the maximum risk-free rate of return the loss corporation could have obtained and the Staff assumed the maximum use of losses would be desired for the entire 15-year carryover period. Under the Staff bill, the rate in effect on the date of the ownership change would be the applicable rate for all post-change years, regardless of any subsequent fluctuations in the rate. In addition, as discussed in further detail below, the amount of the annual limitation would be increased by any "built-in gains" recognized during the year. If the amount of the annual limitation exceeded the losses deducted for a year, the excess would be carried forward to increase the limitation in subsequent years.

In the event of successive substantial changes in ownership, the bill would provide two rules. If the applicable limitation for the second ownership change were less than the limitation for the first ownership change, the second limitation would replace the first limitation and become the relevant limit on the utilization of all losses arising before the second change. If, on the other hand, the second limitation were greater than the first limitation, the two limitations would operate in tandem. In particular, the utilization of losses arising prior to the first ownership change would continue to be subject to the first limitation, while any losses arising after the first change 9/ would be deductible following the second change to the extent the second limitation exceeded the amount of taxable income that is offset as a result of the first limitation.

8/ The Staff bill would define the value of the loss corporation as the fair market value of the stock of the corporation. According to the Staff explanation, the price paid for a substantial portion of a corporation stock would be indicative of the stock's fair market value. In view of the difficulty that may arise in valuing a corporation's equity, consideration should be given to the creation of a statutory presumption that the value of a loss corporation would be presumed to be equal to the purchaser's "grossed-up" basis in the loss corporation stock plus assumed liabilities in any case in which at least 80 percent of the loss corporation stock is acquired during a relatively short period.

9/ Any losses recognized between the two changes that were treated under the rules discussed below as built-in losses with respect to the first change would continue to be subject to the first limitation. No losses recognized after the second change, however, would be treated as built-in losses with respect to the first change.

Capital Contributions

Because the extent to which net operating loss carryovers may be utilized following an ownership change is dependent, under the Staff bill, upon the value of the loss corporation, the bill would provide a rule designed to prevent that value from being inflated in anticipation of an ownership change. In particular, any capital contribution made at any time as part of a plan the principal purpose of which is to avoid the limitations would not be taken into account in determining the value of the loss corporation or in applying the built-in deduction rules. Further, the bill would provide that any capital contribution made during the two years preceding an ownership change would be presumptively treated as part of a plan to avoid the limitations, except as provided in Treasury regulations, and thus would not be taken into account in determining the loss corporation's value.

Investment Companies

Under the bill, a special "anti-abuse" rule would be provided to prevent the utilization of net operating loss carryovers following a substantial change in the ownership of a corporation that is essentially a nonoperating corporation with favorable tax attributes. In particular, the bill would disallow the use of net operating loss carryovers and other tax attributes following a substantial change in the ownership of any corporation if two-thirds or more of the corporation's total assets consist of assets held for investment.

While no definition of the phrase "assets held for investment" is provided in the bill, the explanation prepared by the Staff states that assets that had been used in an active trade or business would not be considered investment assets, regardless of whether the business is actively conducted at the time of the substantial change in ownership. The investment company rule also would not apply if a corporation sold its active business assets shortly after a substantial change in ownership. The Staff explanation states, however, that the step transaction doctrine generally would apply in determining whether a corporation held assets for investment. If, therefore, a corporation that owned active business assets agreed to dispose of those assets prior to a change in the corporation's ownership, but delayed the disposition until after the ownership change, the step transaction doctrine would apply to collapse the disposition of the assets and the change in ownership. The corporation would thus be treated as holding its assets for investment and would not be permitted to utilize any net operating loss carryovers following the ownership change.

Built-in Gains and Losses

The bill would provide a comprehensive set of rules regarding the treatment of "built-in" gains and losses. Built-in gains and losses are simply unrealized differences between the value and adjusted basis of assets that exist at the time of a substantial change of ownership. In general, the bill would treat built-in losses in the same manner as net operating losses incurred prior to the change of ownership, and would thus subject the

deductibility of those losses to the annual limitation. Conversely, built-in gains would be treated as if they had been recognized prior to the change of ownership, and were thus able to be offset by net operating losses incurred prior to the ownership change. Accordingly, the amount of built-in gains recognized after the ownership change would increase the limitation for that year.

The bill would provide several simplifying assumptions and a de minimis rule to mitigate the complexities associated with special treatment of built-in gains and losses. First, a corporation would be treated as having built-in gains or losses only if the fair market value of all its assets immediately before the change in ownership was more or less, respectively, than the aggregate basis of its assets. Thus, a corporation would have either a net built-in gain or a net built-in loss, and would not have to account for both built-in gains and losses with respect to individual assets. In effect, therefore, the bill would net a corporation's unrealized gains and losses against each other for purposes of these rules. Moreover, a de minimis rule would provide that a corporation would not have to account for built-in gains or losses if the aggregate net built-in gain or loss was 25 percent or less of the fair market value of the corporation's assets. This rule would confine the complexity of accounting for the built-in gains or losses to those corporations for which net built-in gains or losses are significant.

If a corporation has an aggregate built-in loss that exceeds 25 percent of the fair market value of its assets, then any losses recognized in the five years following an ownership change (the "recognition period") would be presumed to be built-in losses, and would thus be subject to the applicable annual limitation in the same manner as net operating losses incurred prior to the ownership change. A loss recognized during the recognition period would not be treated as a built-in loss only if the corporation was able to establish that the loss arose after the ownership change.

If, on the other hand, a corporation has a built-in gain that exceeds 25 percent of the fair market value of its assets, then gains recognized during the recognition period would be treated as built-in gains if the taxpayer was able to establish that the gain arose before the ownership change. 10/ Any such recognized built-in gains would be added to the applicable limitation, and would thus permit the corporation to offset the gain without limitation against losses incurred prior to the ownership change.

10/ Under the bill, therefore, while losses recognized during the recognition period are presumed to be built-in, any gains recognized during that period are presumed not to be built-in, unless the taxpayer was able to establish to the contrary.

Title 11 Bankruptcy Proceedings

Under the general provisions of the Staff bill, an exchange of stock for debt would constitute a substantial change of ownership if the creditors participating in the exchange received more than 50 percent of a corporation's stock. In a typical bankruptcy situation, therefore, the limitations would become applicable upon the acquisition of control by the creditors. Because the value of an insolvent corporation's stock would be zero, the applicable limitation would be absolute.

Recognizing the facts that the creditors of a loss corporation are often the economic equivalent of shareholders, that a shift in status from creditor to shareholder may have occurred gradually over an extended period, and that the Congress has in the past provided insolvent corporations with various incentives to rehabilitate themselves, the Staff bill would provide a limited exception from the strict application of the underlying theory for corporations that experience an ownership change in the course of a Title 11 or similar proceeding. In particular, if the shareholders and creditors of such a corporation immediately before any exchange of stock for debt own at least 50 percent of the stock of the corporation after the exchange, then no limitations on the post-exchange use of net operating loss carryovers would apply. In effect, therefore, the bill treats the creditors of a corporation in a Title 11 proceeding as shareholders.

Extending the treatment of these creditors to its logical conclusion, the bill would treat the interest paid to such creditors as dividends and any accrued interest with respect to such debt would be eliminated from the corporation's surviving net operating loss carryovers. Thus, the bill would provide that the net operating loss carryovers of a corporation entitled to this relief would be reduced by the amount of interest paid or accrued by the corporation during the three years preceding the ownership change with respect to any debt exchanged for stock in the Title 11 proceeding.

Finally, the bill would provide an additional limitation on corporations that qualify for the Title 11 exception. If a formerly insolvent corporation experiences a substantial change of ownership within two years of the Title 11 proceeding, then the limitation following the second ownership change would be absolute. In this manner, the bill assumes that any value of such a corporation's stock must be the result of capital contributed by the new owners. Because capital contributions made two years prior to an ownership change are generally ignored under the bill, the value of the stock at the time of the second ownership change must be reduced by the amount of such contributions. Accordingly, the bill would assume that the value of the corporation's stock was zero and no net operating loss carryovers could be utilized following the second change.

Substantial Change in Ownership

The limitations imposed under the bill would generally become applicable when the shareholders of a loss corporation change by more than 50 percentage points during any three-year "testing period." In the case of any change in the shareholders' respective stock 11/ ownership by purchase, redemption, new stock issue or other means, the limitations would apply if, immediately after the change, the value of stock owned by the five-percent shareholders has increased or decreased by more than 50 percentage points over their stock ownership at any time during the three-year testing period. In the case of a reorganization, 12/ the limitations would apply if, immediately after a reorganization, the value of the stock in the surviving corporation owned by shareholders of the loss corporation is more than 50 percentage points less than the value of the stock of the loss corporation owned by the shareholders at any time during the testing period. In general, therefore, the limitations would apply following a reorganization unless the shareholders of the loss corporation did not maintain control of the surviving corporation.

The bill would specify a series of transactions that would not be taken into account in determining whether an ownership change has occurred. Exceptions would be included for transfers by gift, inheritance, bequest, or by reason of divorce or separation. The acquisition of employer securities under an employee stock ownership plan or other qualified plan also would be disregarded.

Other Limitations

The bill would provide that section 269 would not apply to disallow any loss deduction or credit after an ownership change to which the proposed limitations apply. The Staff explanation also states that the Libson Shops doctrine would have no continuing applicability in determining the extent to which net operating loss carryovers may be used following an ownership change. Finally, the Treasury Department would be directed to consider the extent to which the consolidated return regulations would be modified to reflect the proposed limitations.

11/ The bill would define stock as any stock other than preferred stock described in section 1504(a)(4).

12/ Reflecting the new definition of acquisitions proposed by the Staff in other areas, the bill refers to a "qualified asset acquisition." If the proposed limitations were enacted separate from the other Subchapter C changes, appropriate modifications in the definition would of course be necessary.

Detailed Analysis of the Proposal

Overview

The Treasury Department strongly supports the method of limiting the utilization of net operating loss carryovers and other tax attributes following a substantial change in a loss corporation's ownership that is proposed in the Final Staff Report. Following publication of the Preliminary Staff Report, we testified in general support of limiting the use of net operating loss carryovers after an acquisition by reference to the assumed future earnings on the loss corporation's value. We stated, however, that the mechanism preliminarily proposed by the Staff, which as described above contemplated one rule applicable to reorganizations and a second rule applicable to stock purchases, could be improved and simplified by adoption of a single rule applicable to all acquisitions. We continue to believe that a single rule, as now proposed by the Staff, is preferable to the more complicated approach, and we are confident that the proposal made in the Final Staff Report generally offers the best means of reforming the inadequate current law limitations on the carry over of net operating losses and other tax attributes. Accordingly, we urge the Committee to adopt the proposed limitations in substantially the form proposed by Staff. We believe, however, that several minor changes, discussed further below, should first be made.

Proper Rate Of Return

Once an approach limiting the utilization of carryovers based upon a percentage of value is adopted, the most important decision is to determine the rate of return that should be used to set the annual limitation on the use of net operating losses and other tax attributes. 13/ In order to ensure that

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13/ An explicit choice of the applicable rate of return would be unnecessary under an alternative approach that would limit the utilization of net operating loss carryovers and other tax attributes after either a purchase or reorganization to an amount equal to the purchase price of the loss corporation. This approach is arguably the equivalent of the Staff proposal as the purchase price can be viewed as the discounted present value of the stream of income expected to be earned with respect to the loss corporation's assets. By limiting the total amount of net operating loss carryovers and other tax attributes that would survive a purchase or reorganization, this alternative would not impose any restriction on when the available carryovers can be utilized. Thus, under this alternative, the entire net operating loss carryover could be deducted by the corporation in the year immediately following the change of ownership, regardless of

utilization of the net operating loss carryovers would not be affected by an acquisition and that the value of the carryovers would not be increased or decreased as a result of an acquisition, the theoretically correct limitation rate would be the rate at which the loss corporation would have used the net operating loss carryover if no acquisition had occurred. In our view, however, a rule that would in each case require the identification of the earnings attributable to the loss corporation's assets would not be administrable. Several approaches for approximating the theoretically correct rates have been suggested.

First, the limitation rate could be based on a market interest rate. This approach, which forms the basis of the bill proposed by the Staff, was first proposed by the American Law Institute. Such a market-rate based approach implicitly assumes that a loss corporation could have earned this rate on its assets and, therefore, could have absorbed its net operating loss

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13/ Continued: the amount of income attributable to the loss corporation's assets or the age of the carryovers. While it can be argued that this approach is no more generous than the Staff proposal when viewed on a present value basis, it does not attempt to reflect the manner in which the loss corporation could have used the net operating loss carryovers. In this way, the approach violates the principle that net operating loss carryovers should become neither more nor less valuable in the hands of the acquiring corporation, the theoretical basis underlying the proposed limitations. Moreover, by allowing the entire net operating loss carryover to offset income of the acquiring corporation this approach may favor large acquirors at the expense of smaller corporations. A similar approach, which has been suggested by the American Bar Association, would generally limit the utilization of net operating loss carryovers, capital loss carryovers, and excess tax credits to 24 percent of the loss corporation's value per year for the five-year period following the change of ownership. This alternative is based on the view that the purchase price represents the correct limitation, but that it should be spread over some period of time to avoid undue potential acceleration of the carryovers. Because this approach is premised on the view that the purchase price reflects the correct limitation, this alternative suffers the same flaws as the purchase price limitation described above. Because adoption of either of these alternatives would in varying degrees potentially accelerate use of net operating loss carryovers and other tax attributes following an acquisition and would thus violate the sound theoretical base underlying the Staff proposal, the Treasury Department does not support either approach.

carryovers at this speed. The loss corporation could obtain a market rate of return, for example, by selling its assets and investing the proceeds in Treasury bonds. The use of a market rate of return, as suggested below, however, may violate the principle that net operating losses should not become more or less valuable as a result of an acquisition in cases in which the loss corporation could not or would not earn a market rate on its value.

An alternative approach for setting the limitation rate would be based on the average rate at which corporations actually absorb net operating loss carryovers. The determination of this average absorption rate presents several difficulties. In particular, a decision would have to be made concerning the group of corporations that should be used to determine the average rate. Most loss corporations continue to experience losses and continue to increase, rather than absorb, their net operating loss carryovers. If this group of corporations were used to determine the average rate at which net operating loss carryovers are absorbed, the limitation rate would be set at or near zero. A more generous assumption would be that all loss corporations that are acquired have "turned around," and experience, or are about to experience, taxable profits. Preliminary analysis indicates that, in 1981, corporations with taxable income that used net operating loss carryovers absorbed an average amount of such carryovers equal to approximately 5.5 percent of their book net worth. An even more generous assumption would be that an acquired loss corporation is not generally different from the average taxpaying corporation. Preliminary analysis indicates that the average absorption rate for all corporations was approximately 6.5 percent of book net worth in 1981. In short, the average absorption rate approach suggests that the limitation rate should be in the range of zero to seven percent.

Whether the limitation rate to be specified is based on an average absorption rate or on a market interest rate, an adjustment may be necessary to avoid double counting, if the limitation, for administrative reasons, were based on the purchase price of the stock or the value of the corporation's equity. Because the proposed rule is designed to reflect the income that could have been earned by the corporation's productive assets and because the purchase price or value of the corporation's stock will reflect the value of the net operating loss carryover and other tax attributes as well as the value of the assets, the stock value used to compute the limitation theoretically should be adjusted downward to eliminate the value of the net operating loss carryovers and other tax benefits.

Because adoption of a single rate of return represents only an approximation of a corporation's actual return on its assets, the limitation imposed under the Staff approach will be accurate only on average and, therefore, no particular rate can truly be considered the correct rate. Recognizing the potential adverse effect that an averaging approach may have on specific transactions, we believe that the rate selected should not be set at the lowest rate that is theoretically justified. Rather, the rate selected should reflect the inherent imprecision of the approach, and the facts that any corporation may elect to earn a market return by selling its assets and investing the sales proceeds in financial instruments and that any specific corporation may earn a rate of return that is greater than the average return. At the same time, the rate selected should not be so high as to provide an overly generous limitation. In this regard, while we believe that the rate selected by the Staff, the long-term Federal rate, represents a reasonable choice, we believe that the rate should instead be set at the Federal mid-term rate. Such a rate, in practice, often represents a mid-point in the range of possible rates and, in our view, would better reflect the competing considerations that must be balanced.

Capital Contributions

As discussed above, the theory underlying the Staff proposal is generally to limit the utilization of net operating losses and other tax attributes following an ownership change to the earnings attributable to the value of the loss corporation at that time, as that value represents the pool of capital that suffered the losses. The Staff bill would thus properly provide a safeguard to prevent historic shareholders from intentionally inflating the value of the loss corporation in anticipation of a change in ownership.

While we agree that a limitation on infusions of capital is necessary, we believe that the rule proposed by the Staff may create too much uncertainty and should thus be narrowed slightly. In particular, we agree that any capital contribution made during the two-year period preceding an ownership change should be ignored in determining a loss corporation's value, for purposes of both computing the applicable limitation and applying the built-in gain or loss de minimis rule. Moreover, we agree that contributions of property made during the two-year period also should be disregarded in computing the net built-in gain or loss. Because many capital contributions will be motivated by concerns unrelated to the application of subsequent limitations on the use of net operating loss carryovers, such as contributions made in the ordinary course of business, we also believe that Treasury regulations should be permitted to provide exceptions from the rule for certain contributions that are not made in anticipation of an ownership change.

While this approach is virtually identical to the proposal, the Staff bill would provide further that capital contributions made more than two years before an ownership change also would reduce the loss corporation's value if the principal purpose of the contribution, among other prohibited purposes, was to increase the ability of the loss corporation to utilize net operating loss carryovers following an ownership change. We believe that the limited benefits to be gained by attempting to police capital contributions made more than two years before an ownership change is outweighed by the uncertainty such a provision would cause. In this regard, the relationship between the investment company rule discussed below and this capital contribution rule should be understood. For the reasons discussed below, we believe that any significant abuse potential created by limiting the capital contribution rule to a two-year period would be cured by a slightly modified investment company rule. Accordingly, we recommend that capital contributions made more than two years before an ownership change should be outside the scope of the rule governing capital contributions.

Investment Companies

An important issue that must be confronted when formulating limitations on the utilization of net operating loss carryovers is whether a loss corporation that has converted operating assets into investment assets should be able to transfer its net operating losses incurred with respect to the operating assets. The Staff bill, in order to prevent purely tax-motivated acquisitions of such corporations, would prohibit the carry over of all net operating losses following a change in the ownership of a corporation two-thirds or more of the assets of which were investment assets at the time of acquisition.

We believe that, in theory, a corporation owning only investment assets should be able to retain and to transfer its net operating loss carryovers to the same extent as a corporation that owns primarily operating assets, so long as the rules relating to contributions to capital and new stock issues prevent avoidance of the applicable limitations. Indeed, in the context of an approach based on an interest-like rate of return on the loss corporation's value, it is particularly difficult to distinguish between a loss corporation that continues to own its operating assets and one that has converted those assets into passive investment assets. We also are concerned, as reflected by the absence of any precise definition in the Staff bill, that it would be difficult to define the term investment assets in many industries, including banking, insurance, and securities. Finally, applying special rules to corporations that convert operating assets into investment assets may have the undesirable effect of encouraging loss corporations to retain unprofitable businesses rather than convert them into more liquid investments.

The unlimited ability to sell a corporation the assets of which consist of only investment assets and net operating loss carryovers, however, would be perceived as being abusive and thus might affect the public's view of the tax system. Moreover, the public may perceive investment assets held by an acquired corporation as merely a reduction in its purchase price or acquisition value. Accordingly, we do not oppose a rule limiting the carry over of net operating losses by companies that own substantial investment assets.

We believe, however, that the provision proposed by the Staff may be both too harsh in some circumstances and too lenient in others. In particular, we believe that the "cliff effect" caused by completely eliminating the net operating loss carryovers of a corporation that holds two-thirds or more of its assets for investment may be too harsh. Yet the two-thirds threshold test may be too generous in other instances where the perceived abuse at which the rule is directed is present, but the loss corporation's investment assets fall below that threshold. In some respects, such investment assets may in fact be viewed as a partial reduction in the purchase price (or value) of the loss corporation stock.

Consequently, the Treasury Department believes that an appropriate investment company rule would provide that, for any corporation that owns substantial investment assets 14/ (e.g., at least one-third of its value), the investment assets should be disregarded for purposes of computing the applicable limitation on the post-change utilization of net operating losses. 15/ Such investment assets also should be disregarded in determining whether a corporation has a net built-in gain or loss and in applying the built-in gain or loss de minimis rule. In this manner, the cliff effect inherent in the Staff's approach

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14/ The Staff explanation states that assets held in an "investment business," however active, would constitute investment assets. We believe this statement should be modified to ensure that the bill provides clearly that the investment company rule would not operate automatically to deny the availability of net operating losses to banks, insurance companies, and other financial institutions. Depending upon the scope of any such exception applicable to financial businesses, however, consideration should be given to applying a stricter capital contribution rule to such corporations.

15/ In this regard, we believe consideration should be given to disregarding investment assets only to the extent they exceed loss corporation indebtedness. For those corporations that own investment assets in excess of the threshold, consideration also could be given to disregarding investment assets only to the extent they exceed some floor below the threshold.

would be avoided and the investment company rule would apply to some extent to all corporations that own relatively large amounts of investment assets. Finally, in order to avoid difficult valuation problems, consideration should be given to using basis, rather than value, in determining the amount of non-readily tradable investment assets held by a corporation.

Built-in Gains and Losses

As reflected in the Staff's proposal, a built-in loss is economically equivalent to any pre-acquisition net operating loss, and, in the Treasury Department's view, should be subject to the same limitations as net operating loss carryovers and other favorable tax attributes. Similarly, if a corporation with appreciated assets and net operating loss carryovers is sold and the limitations become applicable, pre-acquisition net operating loss carryovers should be available to offset without limitation any income resulting from the realization of built-in gains.

We recognize that the theoretically correct treatment of built-in gains and losses described above may entail significant complexity. Most importantly, special treatment of built-in gains or losses will in many circumstances require valuation of a corporation's assets. Consequently, as we have testified in the past, appropriate de minimis rules and simplifying assumptions must be carefully considered. In this regard, the Treasury Department believes the Staff proposal generally represents a sound method of accounting for built-in gains and losses. In particular, we support the concept of netting built-in gains against built-in losses and thus requiring corporations to account for either built-in gains or built-in losses, in an amount not exceeding the net built-in amount. Moreover, we support a de minimis rule of the magnitude proposed by the Staff.

We believe, however, that the Staff bill is deficient in limiting its scope to built-in gains or losses recognized after the ownership change and, with respect to so-called built-in deductions, providing only that the Secretary of the Treasury would be authorized to prescribe appropriate regulations. In the view of the Treasury Department, the applicable statutory provisions should state affirmatively that built-in deductions, including deductions that accrue prior to an ownership change as well as a portion of depreciation deductions attributable to assets with a basis in excess of value, should be accounted for in the same manner as recognized built-in losses and subject to the applicable limitation. An issue this important should not be left solely to regulations.

Although we recognize that special treatment of built-in deductions, particularly depreciation, may require more detailed asset valuation than the Staff bill, such deductions are usually more significant than recognized losses and should be subject to the applicable limitation. We would be happy to work with the staff in devising the statutory rules that would be necessary to account correctly for these deductions.

Title 11 Bankruptcy Proceedings

The general approach reflected in the Staff bill suggests that no net operating loss carryovers should be available following a substantial change in the ownership of an insolvent corporation. In particular, because the value of the loss corporation at the time of the ownership change would presumably be zero, the annual limitation would be absolute. The bill, however, provides a special exception for corporations that experience an ownership change in the course of a Title 11 or similar proceeding. In summary, the Staff bill treats creditors of such a corporation as if they were shareholders. Thus, no ownership change is considered to have occurred following an exchange of debt for stock in a Title 11 proceeding, if the creditors and shareholders together retain control of the corporation.

The Treasury Department generally agrees that the creditors of an insolvent corporation are frequently the parties that economically bear the losses that are reflected in the net operating loss carryovers and are thus analogous to shareholders, and that, moreover, their shift in status may have occurred gradually. Consequently, we support the concept that an exception from strict application of the rules should be provided for insolvent corporations and that certain creditors of such corporations may be viewed as shareholders.

We also support the provision in the Staff bill providing that no carryovers would survive a second ownership change within two years of an exempted change that occurred in the course of a Title 11 proceeding. In our view, any increase in the value of a formerly insolvent corporation that occurs within two years of an insolvency proceeding is fairly assumed to be the result of capital contributions made during the two-year period. Because capital contributions made during the two years preceding an ownership change are generally disregarded, the applicable value of such a formerly insolvent corporation at the time of the second change is properly assumed to be zero. While we believe an exception from application of the general rules is appropriate, a further exception from application of the theory upon a successive change outside a Title 11 or other insolvency proceeding is neither necessary nor justified.

Although we generally support the provision in the Staff bill applicable to Title 11 proceedings, we have several concerns. First, we believe that only historic creditors should be taken into account in determining whether the exception applies to a loss corporation. The Staff bill, however, provides the exception whenever the shareholders and any creditors of a loss corporation, new or old, retain control following a Title 11 proceeding. In our view, only the historic creditors are fairly assumed to be parties who economically suffered the loss and who are thus analogous to loss corporation shareholders. Accordingly, we believe that allowing new creditors to take advantage of this exception is not justified. Perhaps more importantly, however, extending the exception to new creditors might permit certain abusive transactions.

We also are concerned that resort to Title 11 proceedings may be improperly encouraged by the Staff bill and that informal workouts would be discouraged. We recognize, however, that an informal workout rule must be carefully crafted to ensure that it cannot be used by solvent corporations to avoid application of the general limitations and that it is not unduly complex and difficult to apply. We would be pleased to work with the Committee in refining the Staff proposal, if possible, in a manner that would balance these competing concerns.

Acquisitions by Loss Corporations

In the Treasury Department's view, the primary difference in scope between the approach described in the Preliminary Staff Report and the bill contained in the Final Staff Report is the fact that the Staff bill, because it encompasses only a single rule based on a substantial change of ownership, does not affect acquisitions of tax-paying corporations by relatively large loss corporations. 16/ In summary, under the definition of substantial change of ownership, a stock acquisition of an equally-sized or smaller tax-paying corporation by a loss corporation would not invoke any limitations because the loss corporation shareholders would have maintained the sufficient 50-percent continuity of interest in the surviving corporation.

There are two classes of corporations that could be acquired by relatively large loss corporations in the manner suggested above. First, a loss corporation could acquire a corporation that is expected to produce taxable income that could be offset by the acquiring corporation's net operating loss carryovers. Second, a loss corporation could acquire a corporation that has substantially appreciated assets or other inherent tax liability, the recognition of which could be offset by the acquiring corporation's net operating loss carryovers.

Under the Final Staff Report, as under current law, no meaningful limitations are imposed upon the types of acquisitions described above. The issue which thus arises is whether the Report is deficient is this respect and, if so, whether the Staff bill should be modified to impose some limitations in such circumstances.

Under the Staff bill, no restrictions are generally imposed on the ability of a loss corporation to rehabilitate itself through contributions to capital by the corporation's historic shareholders. A loss corporation with capital contributed by historic shareholders is thus permitted to purchase assets, including an entire corporation, and offset net operating loss carryovers against the income from those assets. In the Treasury

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16/ If the acquiring loss corporation were smaller than the acquired corporation, however, the loss corporation shareholders would own less than 50 percent of the surviving corporation and the utilization of its net operating loss carryovers following the acquisition would thus be limited.

Department's view, this approach is appropriate in the case of purchases, and there is no reason in this regard to distinguish acquisitions of corporations in exchange for loss corporation stock from purchases for cash. Therefore, unless the loss corporation's shareholders surrender control in a stock acquisition, we believe no limitations should in general be imposed on the loss corporation's ability to acquire a tax-paying corporation.

We are somewhat more concerned, however, by the ability of a loss corporation to acquire a corporation with substantially appreciated property or other significant inherent tax liability and to offset the resulting tax with net operating loss carryovers. While we recognize that this is an exceedingly difficult issue, we believe that some consideration should be given to the manner in which this ability could be circumscribed. If a suitable approach can be developed, however, we believe it should be incorporated into the Staff bill.

Other Limitations

Under the Staff bill, section 269 would not be applicable to any transactions that were subject to the proposed limitations. While the Treasury Department believes that the uncertainty created by section 269 is undesirable and often causes purchasers of loss corporations to reduce the price they offer to the loss corporation shareholders, giving the purchasers a potential profit at the expense of such shareholders, we cannot at this time support a substantial restriction in the scope of section 269. We are particularly concerned that the adoption of a new set of limitations without the potential availability of section 269 may result in unanticipated planning opportunities. After we have gained some experience with the efficacy of the new limitations, however, we should reconsider whether the continued applicability of section 269 remains justified. 17/

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This concludes my prepared remarks. I would be happy to respond to questions.

17/ We are similarly of the view that, at this time, the separate return limitation year and the consolidated return change of ownership rules should remain applicable. After experience with the new limitations is gained, the Treasury Department, as suggested in the Staff explanation, would reconsider the continued need for these regulations or whether any modifications would be appropriate.

TREASURY NEWS

Department of the Treasury • Washington, D.C. • Telephone 566-2041

FOR IMMEDIATE RELEASE   September 30, 1985

RESULTS OF TREASURY'S WEEKLY BILL AUCTIONS

Tenders for $6,805 million of 13-week bills and for $6,834 million of 26-week bills, both to be issued on October 3, 1985, were accepted today.

RANGE OF ACCEPTED COMPETITIVE BIDS:	13-week bills maturing January 2, 1986			:	26-week bills maturing April 3, 1986		
	Discount Rate	Investment Rate 1/	Price	:	Discount Rate	Investment Rate 1/	Price
Low	7.06% a/	7.29%	98.215	:	7.24% b/	7.62%	96.340
High	7.08%	7.31%	98.210	:	7.24%	7.62%	96.340
Average	7.07%	7.30%	98.213	:	7.24%	7.62%	96.340

a/ Excepting 1 tender of $15,005,000.
b/ Excepting 1 tender of $1,000,000.
Tenders at the high discount rate for the 13-week bills were allotted 62%.
Tenders at the high discount rate for the 26-week bills were allotted 83%.

TENDERS RECEIVED AND ACCEPTED
(In Thousands)

Location	Received	Accepted	:	Received	Accepted
Boston	$ 68,050	$ 35,050	:	$ 65,055	$ 35,055
New York	18,436,710	5,886,575	:	22,898,250	5,906,320
Philadelphia	22,060	22,060	:	21,310	21,310
Cleveland	63,960	58,990	:	31,290	31,290
Richmond	66,985	57,570	:	69,860	54,110
Atlanta	54,080	38,080	:	86,600	38,600
Chicago	1,093,155	111,155	:	1,233,065	129,065
St. Louis	90,405	50,405	:	90,090	50,090
Minneapolis	66,950	13,950	:	43,020	18,020
Kansas City	56,265	56,265	:	61,200	58,800
Dallas	45,950	35,850	:	28,605	18,605
San Francisco	800,600	112,780	:	1,080,925	70,425
Treasury	326,045	326,045	:	402,670	402,670
TOTALS	$21,191,215	$6,804,775	:	$26,111,940	$6,834,360
Type					
Competitive	$17,861,220	$3,474,780	:	$23,104,880	$3,827,300
Noncompetitive	1,193,585	1,193,585	:	1,099,560	1,099,560
Subtotal, Public	$19,054,805	$4,668,365	:	$24,204,440	$4,926,860
Federal Reserve	1,696,810	1,696,810	:	1,675,000	1,675,000
Foreign Official Institutions	439,600	439,600	:	232,500	232,500
TOTALS	$21,191,215	$6,804,775	:	$26,111,940	$6,834,360

1/ Equivalent coupon-issue yield.

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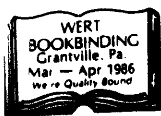
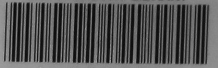

WERT
BOOKBINDING
Grantville, Pa.
Mar — Apr 1986
We're Quality Bound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