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U.S. Department of the Treasury

PRESS RELEASES

AUCTION RESULTS

PUBLIC DEBT NEWS

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July 22, 1991

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JUL 24 91 U026813

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

DEPT. OF THE TREASURY

Tenders for $10,411 million of 13-week bills to be issued July 25, 1991 and to mature October 24, 1991 were accepted today (CUSIP: 912794WV2).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.57%	5.74%	98.592
High	5.60%	5.78%	98.584
Average	5.60%	5.78%	98.584

Tenders at the high discount rate were allotted 74%. The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	38,770	38,770
New York	28,505,890	8,679,510
Philadelphia	27,430	27,430
Cleveland	35,415	35,375
Richmond	53,130	53,130
Atlanta	31,605	31,085
Chicago	1,759,810	366,210
St. Louis	57,715	17,715
Minneapolis	11,070	11,070
Kansas City	31,570	31,570
Dallas	23,595	23,595
San Francisco	615,165	186,565
Treasury	908,665	908,665
TOTALS	$32,099,830	$10,410,690
Type		
Competitive	$27,894,875	$6,205,735
Noncompetitive	1,675,045	1,675,045
Subtotal, Public	$29,569,920	$7,880,780
Federal Reserve	2,467,460	2,467,460
Foreign Official Institutions	62,450	62,450
TOTALS	$32,099,830	$10,410,690

An additional $67,350 thousand of bills will be issued to foreign official institutions for new cash.

NB-1378

AUCTION RESULTS

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July 22, 1991

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RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

DEPT. OF THE TREASURY

Tenders for $10,442 million of 26-week bills to be issued July 25, 1991 and to mature January 23, 1992 were accepted today (CUSIP: 912794XW9).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.70%	5.97%	97.118
High	5.72%	5.99%	97.108
Average	5.72%	5.99%	97.108

Tenders at the high discount rate were allotted 70%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	32,405	32,405
New York	28,762,245	8,790,335
Philadelphia	17,305	17,305
Cleveland	29,405	29,405
Richmond	44,310	42,310
Atlanta	32,085	31,785
Chicago	1,700,940	332,940
St. Louis	35,835	19,335
Minneapolis	7,250	7,250
Kansas City	39,570	39,570
Dallas	17,815	17,815
San Francisco	877,875	322,875
Treasury	759,030	759,030
TOTALS	$32,356,070	$10,442,360
Type		
Competitive	$27,921,775	$6,008,065
Noncompetitive	1,376,345	1,376,345
Subtotal, Public	$29,298,120	$7,384,410
Federal Reserve	2,600,000	2,600,000
Foreign Official Institutions	457,950	457,950
TOTALS	$32,356,070	$10,442,360

An additional $469,450 thousand of bills will be issued to foreign official institutions for new cash.

NB-1379

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DEPT. OF THE TREASURY

For Release Upon Delivery
Expected at 10:00 a.m.
July 23, 1991

STATEMENT OF
KENNETH W. GIDEON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Committee:

I am pleased to present the views of the Administration on H.R. 2777, the Tax Simplification Act of 1991, H.R. 2775, relating to additional tax simplification, and H.R. 1555, the Technical Corrections Act of 1991.

The Administration strongly supports simplification of our tax laws within the fiscal constraints of last year's budget agreement. The benefits of tax law simplification are obvious. When the law is simpler and easier to understand, compliance and enforcement improve and unnecessary disputes are avoided. Simplification reduces taxpayer compliance burdens and, by better assuring more uniform interpretation and administration, improves taxpayer morale. When simplification efforts are successful, we believe that there should be efficiency gains as well. Against these benefits of simplification must be weighed the greater precision which may be achieved by more detailed provisions and the not insubstantial benefits of statutory repose. Our general conclusion with respect to most of the proposals before the Committee today is that they will simplify the law, that they are net improvement over the more complicated provisions they replace, and that the benefits are sufficient to justify change at this time. Where we believe this is not the case, my written statement sets forth the reasons for our opposition or reservations.

The bills I will review today demonstrate that revenue-gaining and revenue-losing simplification proposals can be combined to achieve meaningful simplification without overall revenue loss. Specifically, the Treasury's Office of Tax

Analysis estimates that H.R. 2777 is, in its current form, near revenue neutrality (loss of $88 million in fiscal 1992 and $42 million over the 5-year budget period). Similarly, if section 101 of H.R. 2775 is excluded, that bill is also nearly revenue neutral (loss of $37 million in fiscal 1992 and a gain of $376 million over the 5-year budget period). While the Administration will insist that the simplification bills must ultimately satisfy the pay-as-you-go provision, these revenue figures for the bills demonstrate that that constraint can be satisfied. Where we believe particular proposals in the bill will provide significant simplification but have significant revenue cost, we have qualified our support as subject to an acceptable offset being provided.

Before proceeding to the substance of the bills, I also wish to commend the Committee and its leadership for the manner in which this legislation has been developed. Working from numerous suggestions from the public and the Government, all the staffs of the tax-writing committees, the Joint Committee on Taxation, and the Treasury have worked together to develop these proposals. H.R. 2777 (and its Senate counterpart, S. 1394) enjoys bi-partisan sponsorship in both Houses. The early introduction of legislative language by Chairman Rostenkowski and Mr. Archer will allow all of us to benefit from thoughtful public comment on these bills. I believe that legislation produced in this manner is clearly better for its development in such a process.

While H.R. 2775 contains several commendable simplification proposals, the Administration does not support the bill in its current form. As noted in my written statement, we particularly oppose -- on both policy and budgetary grounds -- the proposed repeal of the young child credit and the increase in the family size adjustment to the basic earned income tax credit.

We support the technical corrections set forth in H.R. 1555 to the tax provisions of the 1990 Omnibus Budget Reconciliation Act (1990 OBRA). We agree that the provisions are technical and that they do not involve any loss of revenue. We note, however, that additional technical corrections may ultimately be required.

The remainder of my written statement is a detailed discussion of the provisions contained in H.R. 2777 or H.R. 2775, other than those relating to simplification of the tax-exempt bond rules and the reporting and audit requirements for large partnerships. Those provisions will be discussed in testimony before the Subcommittee on Select Revenue Measures at separately scheduled hearings.

A. ANALYSIS OF CERTAIN PROVISIONS OF H.R. 2777, THE TAX SIMPLIFICATION ACT OF 1991

TITLE I. INDIVIDUAL TAX PROVISIONS

1. Rollover of Gain on Sale of Principal Residence: Rules Relating to Multiple Sales Within Rollover Period

Current law. No gain is recognized on the sale of a principal residence if a new residence at least equal in cost to the sales price of the old residence is purchased and used by the taxpayer as his principal residence within a specified period of time. This replacement period generally begins 2 years before and ends 2 years after the date of sale of the old residence. In general, nonrecognition treatment is available only once during any 2-year period. In addition, if during the replacement period the taxpayer purchases more than one residence which is used as his principal residence within 2 years after the date of sale of the old residence, only the last residence so used is treated as the new replacement residence. However, if residences are sold in order to relocate for employment reasons, two special rules apply: first, the number of times nonrecognition treatment is available during a 2-year period is not limited; second, if a residence is sold within 2 years after the sale of the old residence, the residence sold is treated as the last residence used by the taxpayer and thus as the only replacement residence.

Proposal. Gain would be rolled over from one residence to another residence in the order the residences are purchased and used, regardless of the taxpayer's reasons for the sale of the old residence. In addition, gain could be rolled over more than once within a 2-year period. Thus, the rules that formerly applied only if a taxpayer sold his residence in order to relocate for employment purposes would apply in all cases.

Administration position. The Administration supports this provision. The provision simplifies the application of section 1034 by amending it to provide a single set of rules for rollover of gain on the sale of a principal residence.

2. Due Dates for Estimated Taxes of Individuals

Current law. Individual estimated taxes for a taxable year must be paid in four installments, the due dates of which are April 15, June 15, and September 15 of that year and January 15 of the following year.

Proposal. The due date for the second installment of estimated tax would be changed from June 15 to July 15.

Administration position. We do not support this proposal. It entails a cost to the government, which would receive the second installment of estimated tax at a later date (thereby foregoing investment earnings on the funds or incurring interest expense on additional borrowings) and would have to revise tax forms and processing capabilities to accommodate the change. The proposal would not meaningfully simplify the law. The intervals between due dates for installments of individual estimated taxes would remain uneven; the 2-month interval that currently exists between the first (April 15) and second (June 15) installments would be replaced by a 2-month interval between the new second (July 15) and third (September 15) installments.

3. Payment of Tax by Credit Card

Current law. Payment of taxes may be made by checks or money orders, to the extent and under the conditions provided by regulations.

Proposal. The bill would permit payment of taxes by checks, money orders and other commercially acceptable means that the Secretary of the Treasury deems appropriate (including payment by credit card) to the extent and under the conditions provided by regulations. In addition, the Secretary would be given the authority to contract with financial institutions for credit card services at rates that are cost beneficial to the Government.

Administration position. The Administration supports these grants of authority. Allowing taxpayers to use credit cards to make tax payments would provide them with an additional option for payment that they have in most other debtor/creditor relationships. The proposal also allows flexibility to permit other commercially acceptable forms of payment.

4. Election to Include Child's Income on Parent's Return

Current law. The net unearned income of a child under 14 years of age is taxed at the marginal rate of the child's parents. If the child's gross income is solely from interest and dividends and is more than $500 and less than $5,000, the parents may elect to report the child's gross income in excess of $1,000 on their return. If the election is made, in addition to the tax on the augmented income, the parents pay the lesser of $75 or 15 percent of the excess of the child's gross income over $500. For purposes of the alternative minimum tax (AMT), the AMT exemption of a child under the age of 14 is limited to the sum of the child's earned income and the greater of $1,000 or the unused parental minimum tax exemption.

Proposal. The dollar amounts relating to the election to include the child's income on the return of the parents would be indexed for inflation. In addition, the $1,000 amount used to determine the amount of the child's AMT exemption would be indexed for inflation.

Administration position. The Administration supports this provision. Adjusting for inflation for purposes of the election will prevent inflation from eroding the availability of the election over time. Because the election reduces the need to file separate returns for young children, preserving the availability of the election simplifies the filing process.

5. Certain Foreign Tax Credits for Individuals

Current law. In order to compute the foreign tax credit, a taxpayer computes foreign source taxable income, and foreign taxes paid, in each of the applicable separate foreign tax credit limitation categories. In the case of an individual, this requires the filing of Form 1116, designed to elicit sufficient information to perform the necessary calculations.

Proposal. On an elective basis, the proposal would eliminate the need for individual taxpayers with less than $200 in creditable foreign taxes to file a Form 1116 or to allocate and apportion expenses to their passive foreign source income reported on a Form 1099. In order to permit the simplified calculation, an electing taxpayer's credit would be limited to the lesser of 25 percent of such passive foreign source income or the total foreign taxes paid.

Administration position. We support this proposal. The bill would simplify the foreign tax credit computations for individuals claiming small amounts of credits.

6. Certain Personal Foreign Currency Transactions

Current law. When a U.S. taxpayer having the U.S. dollar as his functional currency makes a payment in a foreign currency, gain or loss (referred to as "exchange gain or loss") arises from any change in the value of the foreign currency relative to the U.S. dollar between the time the currency was acquired (or the obligation to pay was incurred) and the time that the payment is made. Gain or loss results because foreign currency, unlike the U.S. dollar, is treated as property for Federal income tax purposes. Exchange gain or loss can arise where foreign currency has been acquired for personal use.

Proposal. The bill would exempt from taxation exchange gains not exceeding $200 realized by individuals on the disposition of foreign currency in personal transactions. Losses on such transactions are not allowed under current law.

Administration position. We support this proposal. Taxpayers located abroad generally must conduct their affairs in the local currency. Under current law, taxpayers may be required to recognize exchange gains on dispositions of foreign currency in personal transactions. We agree with the Committee that, in de minimis cases, this imposes unreasonable administrative demands on taxpayers, and that the insignificant amount of revenue collected from such transactions does not justify this administrative burden.

7. Due Date for Furnishing Information to Partners

Current law. Partnerships are required to furnish an information return (Schedule K-1) to each person who is a partner for any partnership taxable year on or before the day on which the return for such taxable year is required to be filed (April 15 for a calendar year partnership).

Proposal. A large partnership (which is a partnership with 250 or more partners or any partnership subject to the simplified reporting rules for large partnerships proposed in H.R. 2777) would be required to furnish information returns to its partners by the 15th day of the third month following the end of its taxable year (March 15, for a calendar year partnership).

Administration position. We support this proposal insofar as it applies to simplified Schedules K-1 issued by large partnerships as described in §201 of the bill. Information returns that are received on or shortly before April 15 are difficult for individuals to use in preparing their returns or computing their payments that are due on that date. It may thus be appropriate to accelerate this date in the case of large partnerships whose tax treatment is being modified (in Title II of this bill) in order to simplify the tax consequences of an investment in the partnership. We question, however, whether this requirement should be extended to partnerships which remain subject to detailed Schedule K-1 reporting or to Schedule K-1's issued to excluded partners of large partnerships.

8. Exclusion of Combat Pay from Withholding Limited to Amount Excludable From Gross Income

Current law. Gross income does not include certain pay of members of the Armed Forces. If enlisted personnel serve in a combat zone during any part of any month, military pay for that month is excluded from gross income. Special rules apply if enlisted personnel are hospitalized as a result of injuries, wounds, or disease incurred in a combat zone. In the case of commissioned officers, these exclusions from income are limited to $500 per month of military pay.

There is no income tax withholding with respect to military pay for a month in which a member of the Armed Forces is entitled to the combat pay exclusion. With respect to enlisted personnel, this income tax withholding parallels the exclusion: there is a total exemption from income tax withholding and total exclusion from income. With respect to officers, however, the withholding rule is not parallel: there is total exemption from income tax withholding, although the exclusion from income is limited to $500 per month.

Proposal. The proposal would make the income tax withholding exemption rules parallel to the rules providing an exclusion from income for combat pay.

Administration position. We support this proposal. The current differences between the withholding rules and the exclusion rules with respect to combat pay can lead to underwithholding on the pay of taxpayers (primarily officers) and could cause hardship at the time of the filing of their tax returns.

9. Simplified Income Tax Returns

Current law. The Treasury Department and the Internal Revenue Service continually study ways to simplify reporting for individuals, both itemizers and nonitemizers.

Proposal. The bill would require the Secretary (or his delegate) to take such actions as may be appropriate to expand access to simplified individual income tax returns and otherwise simplify the individual income tax returns. The bill would mandate that the Secretary (or his delegate) submit a report no later than 1 year after enactment on such actions.

Administration position. We do not oppose this proposal. It mandates that the Treasury Department and the Internal Revenue Service continue existing and continuous activities to evaluate tax forms to make them easier to understand and to improve compliance. We do not believe a formal study should be required.

10. Rural Letter Carriers

Current law. A taxpayer may elect to use a standard mileage rate in computing the deduction allowable for business use of an automobile. Under this election, the taxpayer's deduction equals the standard mileage rate multiplied by the number of miles driven for business purposes, and is taken in lieu of deductions for depreciation and actual operation and maintenance expenses. If the taxpayer is an employee, the deduction is subject to the 2-percent floor on miscellaneous itemized deductions.

If the taxpayer's employer reimburses the taxpayer under an accountable plan for his actual expenses, the reimbursement is excluded from the taxpayer's income. A plan is accountable if it meets requirements of business connection, substantiation, and returning amounts in excess of expenses. Rather than requiring an employee to substantiate the actual amount of his expense, the employer can provide a mileage allowance. If a mileage allowance is paid at a rate not in excess of the standard mileage rate, the reimbursement is excluded from the taxpayer's income. If the mileage allowance is paid at a rate in excess of the standard mileage rate, the excess is included in the taxpayer's income (and is subject to reporting and withholding).

An employee of the U.S. Postal Service may use a special mileage rate equal to 150 percent of the standard mileage rate in computing the deduction for business use of an automobile in performing services involving the collection and delivery of mail on a rural route.

Proposal. The bill would repeal the special mileage rate for U.S. Postal Service employees. In its place, the bill would provide that the rate of reimbursement provided by the Postal Service to rural letter carriers under their 1991 collective bargaining agreement is considered to be equivalent to their actual expenses. This rate can be increased in the future by no more than the rate of inflation. The bill also would provide that the reimbursements are exempt from the accountable plan requirements.

Administration position. The Administration does not oppose the proposal insofar as it treats the reimbursements for automobile expenses provided to rural letter carriers as being equal to their actual expenses. The Administration believes, however, that the reimbursements should be subject to the accountable plan requirements. These requirements do not impose an undue burden on the Postal Service or rural letter carriers.

11. Exemption From Luxury Excise Tax For Certain Equipment Installed On Passenger Vehicles For Use By Disabled Individuals

Current law. The 1990 OBRA imposed a 10-percent excise tax on the portion of the retail price of a passenger vehicle that exceeds $30,000. The tax also applies to the installation of parts and accessories within 6 months of the date the vehicle is purchased.

Proposal. The bill would provide that the luxury excise tax does not apply to a part or accessory that is installed on a passenger vehicle after its purchase in order to enable or assist an individual with a disability to operate the vehicle or to enter or exit the vehicle by compensating for the effect of the disability. The tax would continue to apply to the portion of the retail price of the vehicle that exceeds $30,000, even if the purchaser is disabled and/or intends to make modifications to the vehicle that under the proposal would be exempt from the tax.

Administration position. We support the proposal. We would modify the proposed language slightly in order to clarify that Congress intends the proposal also to apply to structural or mechanical modifications to a vehicle that make the vehicle usable by a disabled person but that may involve the removal or rearrangement, rather than the addition, of parts.

We understand that the proposal is not intended to exclude from the luxury tax accessories such as cruise control, adjustable steering columns, power-adjustable seats, or power windows, door locks, mirrors or sunroofs that are commonly available as optional equipment from the manufacturer or dealer and that might assist any driver in operating the vehicle.

TITLE II. TREATMENT OF LARGE PARTNERSHIPS

To be covered in testimony before the Subcommittee on Select Revenue Measures.

TITLE III. FOREIGN PROVISIONS

1. Deferral of Tax on Income Earned Through Foreign Corporations and Exceptions to Deferral

Current law. Under current law, a U.S. investor in a foreign corporation that earns passive income is potentially subject to six separate and distinct regimes that are designed to prevent him from improperly deferring his U.S. tax on income that is likely to bear little or no foreign tax. One of these regimes -- the Passive Foreign Investment Company (PFIC) regime -- itself consists of three separate sets of rules, because of taxpayer elections available to alter the timing and method of tax. These regimes are not only numerous; they are also complex and redundant. They impose excessive burdens on both taxpayers and the government in determining the correct U.S.

tax liability for foreign-earned passive income. Two of the regimes were designed primarily to attack non-business-related accumulations by domestic corporations; they impose a penalty tax at the corporate level. The other four regimes were targeted specifically at accumulations by foreign corporations and apply at the shareholder level. These various regimes were enacted over a period of 60 years and are not adequately coordinated.

Proposal. The bill would consolidate the anti-deferral rules applicable to foreign corporations earning substantial amounts of passive income.

Administration position. We support the proposal in the bill as a substantial simplification of the current statutory scheme. Under the bill, taxpayers will no longer have to contend with the overlap and inconsistencies among the multiple regimes. Instead, shareholders will be taxed under a single integrated regime which provides one of three methods of tax, depending on the extent of U.S. ownership of the foreign corporation and whether its stock is publicly traded.

The single regime applies to passive foreign corporations (PFCs). A PFC is defined in a way that eliminates overlap and potential inconsistencies between the current PFIC and foreign personal holding company regimes. All shareholders of U.S.-controlled PFCs, and large shareholders and electing small shareholders of foreign-controlled PFCs, will be taxed currently under the existing Subpart F rules. This will cover most if not all of U.S. corporate participation in multinational enterprises. Non-electing small shareholders of foreign-controlled PFCs will pay tax annually on a "mark-to-market" basis if their PFC stock is publicly traded, and will be taxed under rules similar to the so-called "interest charge" rules of the current PFIC regime if their PFC stock is not publicly traded.

2. Modifications to Provisions Affecting Controlled Foreign Corporations

Current law. A United States shareholder is taxed currently on its pro rata share of a controlled foreign corporation's (CFCs) Subpart F income and is allowed a corresponding increase in its basis in the CFCs stock. When the CFCs earnings attributable to such Subpart F inclusions are later distributed, the dividends are excluded from the shareholder's income to avoid double taxation of the previously taxed amounts. A shareholder receiving the distributions is permitted to make special adjustments to allow it to claim credits for foreign taxes paid with respect to the distribution. If the United States shareholder sells its stock in the CFC, all or a portion of the gain on the sale may be recharacterized as a dividend; to the extent so recharacterized, the foreign tax credit rules apply, in many respects, as if the shareholder had received an actual dividend from the CFC.

Proposal. The bill contains a number of amendments to the rules for taxing U.S. shareholders of CFCs. In general, these amendments are aimed at reducing the possibility of excessive taxation of foreign earnings. In one instance the amendments would repeal (subject to transition rules) a provision that imposes substantial recordkeeping requirements on foreign corporations and their shareholders while conferring what appears to be a relatively minor benefit.

Administration position. We support these proposals as further implementing the existing general policy under Subpart F that the income of a CFC, having once been taxed to its United States shareholders, should not be taxed again. We note that the proposals give discretion to the Secretary in certain cases to take administrative or other concerns into account in implementing the proposals through the issuance of regulations. Although the proposed repeal of section 960(a)(3) may increase the tax burden on certain income earned through a CFC, we believe that this increased burden is likely to be minor (especially in view of the transition rules) and is outweighed by the substantial reduction in complexity.

3. Translation of Foreign Taxes into U.S. Dollar Amounts

Current law. Section 986(a) requires foreign taxes, paid in a foreign currency, to be translated into U.S. dollars for purposes of claiming a foreign tax credit at the exchange rate on the date of tax payment. Many U.S. multinationals have complained that the "date of payment" rule imposes a significant administrative burden, without promoting any substantial U.S. tax policy interest. The burden arises from the taxpayer's need, in many cases, to determine the foreign exchange rate for a very large number of separate tax payments made in different currencies on different dates, and then maintain appropriate records for these payments and exchange rates.

Proposal. The bill would give the Secretary the authority to permit use of an average exchange rate for an appropriate period, determined by regulation, rather than the exchange rate on the specific payment date.

Administration position. We support the bill's solution to this problem. Use of an average rate may not always be appropriate -- for example, in hyperinflationary currencies. The bill will permit us to write regulations providing sensible answers to practical problems, without reopening the policy debate settled by the 1986 Tax Reform Act.

4. Foreign Tax Credit Limitation Under the Alternative Minimum Tax

Current law. A U.S. taxpayer claiming a foreign tax credit must compute its taxable income from foreign sources as well as its overall, or worldwide, taxable income. Moreover, this computation must be done for each of several foreign tax credit "baskets" of income. To compute its foreign source taxable income within each of these baskets, the taxpayer must allocate and apportion its expenses. This procedure is complex and time-consuming, but it is fundamental to the correct operation of the foreign tax credit rules. In addition to these computations, a taxpayer may also be required to compute its foreign tax credit for alternative minimum tax purposes. Since taxable income for AMT purposes is different from taxable income for regular tax purposes, this requires a recomputation of foreign source taxable income, and therefore a reallocation and apportionment of expenses, in each of the foreign tax credit baskets.

Proposal. The bill would simplify the AMT foreign tax credit computation by permitting the taxpayer to elect to use its regular, rather than its AMT, foreign source taxable income in each of the baskets.

Administration position. We support the proposal. In many cases we believe that there will not be significant differences between a taxpayer's regular versus its AMT foreign source taxable income in the different baskets. Where there may be significant differences, the taxpayer need not elect the new rule. In this regard, it is important to note that the election must be made once, for all future taxable years. This is an appropriate limitation: it will prevent taxpayers from engaging in costly and complex computations of both AMT and regular foreign source taxable income each year to determine whether the election, in that year, would be cost effective.

TITLE IV. OTHER INCOME TAX PROVISIONS

A. S Corporations

1. Determination of Whether an S Corporation Has One Class of Stock

Current law. A corporation is not a small business corporation, and therefore cannot elect S corporation status, if the corporation has more than one class of stock. Differences in voting rights are disregarded in determining if a corporation has more than one class of stock and debt instruments meeting the requirements of a safe harbor are not treated as a second class of stock. The Code and legislative history do not provide any other guidance as to what may or may not constitute a second class of stock.

Proposal. A corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds. The determination of whether the outstanding shares of a corporation confer identical rights is made taking into account rights arising under the corporate charter, activities of incorporation or by-laws, legal requirements, administrative actions, and any agreements that are legally enforceable under state law. The provision does not limit the Internal Revenue Service's ability to properly characterize S corporation transactions for Federal income tax purposes.

Administration position. The Administration supports this provision. The provision clarifies the intended scope of the one class of stock requirement. A new set of proposed regulations consistent with this provision will soon be issued.

2. Authority to Validate Certain Invalid Elections

Current law. S corporation status is not automatic for qualifying corporations. All of the shareholders of a small business corporation must consent to the election of the corporation to be an S corporation. The election may be made by a small business corporation for any tax year at any time during the preceding tax year or at any time on or before the 15th day of the third month of the current tax year. Any late election made after the 15th day of the third month is treated as an election for the following tax year. Moreover, where an election timely made during the current tax year is invalid for that year because one or more of the shareholders failed to consent to the election, or because the corporation had too many shareholders, an ineligible shareholder, or more than one class of stock, the election will be treated as having been made for the following tax year if the impediment is removed.

Proposal. The Internal Revenue Service would be given authority to waive the effect of an invalid election caused by the inadvertent failure to qualify as a small business corporation or to obtain the required shareholder consents. The Internal Revenue Service would also be authorized to validate an untimely election where the untimeliness is due to reasonable cause.

Administration position. The Administration supports this provision. It would allow the Internal Revenue Service to provide an administrative remedy for untimely or invalid elections in appropriate circumstances.

3. Treatment of Distributions by S Corporations During Loss Year

Current law. The total amount of a shareholder's portion of the losses and deductions of an S corporation may be taken into account by the shareholder only to the extent that the total does not exceed the basis of his stock and the basis of indebtedness owed to the shareholder by the corporation. Any loss or deduction that is disallowed may be carried over indefinitely.

Distributions by an S corporation generally are treated as a nontaxable return of capital to the extent of a shareholder's basis in his or her stock. The shareholder's stock basis is reduced, but not below zero, by the tax-free amount of the distribution. Any distribution in excess of the shareholder's basis is treated as a capital gain.

The basis of each shareholder's stock in an S corporation is increased by his or her pro rata share of certain items of income and decreased by his or her pro rata share of certain items of loss and deduction. Current law is unclear as to whether adjustments to basis for income, loss and deduction items must take place before or after adjustments for distributions. If the loss and deduction items reduce basis more than the income items increase basis, making such adjustments to basis before adjustments to basis are made for distributions would reduce the amount of the distributions that would be a tax-free return of capital. Such a result would be inconsistent with the partnership rules which provide that for any taxable year a partner's basis is first increased by items of income, then decreased by distributions, and finally decreased by losses.

A similar characterization problem arises with respect to distributions by S corporations with accumulated earnings and profits. Distributions by such corporations are treated: (1) as a nontaxable return of capital to the extent of the corporation's "accumulated adjustments account" (essentially the aggregate taxable income of the corporation for all years beginning after 1982 to the extent that such taxable income has not been distributed to shareholders), (2) as a dividend to the extent of the S corporation's accumulated earnings and profits, (3) as a nontaxable return of capital to the extent of the remaining basis of the shareholder's stock, and (4) as capital gain. For purposes of determining the effect of a distribution for any taxable year, adjustments reflecting the corporation's items of income, loss and expenses are made to the accumulated adjustments account in a manner similar to the adjustments required to be made to the shareholders' stock basis.

Proposal. The proposal would clarify that adjustments to basis for distributions during a year are made before adjustments to basis for items of loss. Accordingly, the extent to which losses may be taken into account for a taxable year would be determined after the tax status of distributions has been determined.

In addition, if for any year an S corporation's items of loss and expense exceed its items of income, the adjustments that would otherwise be made to the accumulated adjustments account are disregarded in determining the effect of distributions made during the taxable year. This rule affects only distributions made by S corporations with accumulated earnings and profits.

Administration position. The Administration supports this provision. It would harmonize the basis adjustment provisions relating to partnership interests and S corporation stock and would provide a measure of certainty to shareholders of S corporations regarding the tax treatment of distributions made during loss years.

4. Treatment of S Corporations as Shareholders in C Corporations

Current law. An S corporation in its capacity as the shareholder of a C corporation is treated as an individual for purposes of subchapter C. In a private letter ruling, the Internal Revenue Service has interpreted this rule as preventing the tax free liquidation under section 332 and 337 of a C corporation subsidiary into an S corporation because a C corporation cannot liquidate tax-free when owned by an individual shareholder. However, the result desired by the taxpayer can be achieved on a tax-free basis by either having the S corporation purchase the C corporation and having the C corporation merge into the S corporation after the purchase or by having the S corporation lend money to its shareholders to purchase the C corporation who would then merge the C corporation into the S corporation.

Proposal. The bill would repeal the rule that treats an S corporation in its capacity as a shareholder of a C corporation as an individual.

Administration position. The Administration supports this provision. It would remove a trap for the unwary by treating the liquidation of a C corporation into an S corporation in the same manner as the merger of a C corporation into an S corporation or a conversion from C to S status. As is currently the case when a C corporation merges into an S corporation, the built-in gains of the liquidating C corporation would be subject to the built-in gains tax provisions of section 1374.

5. S Corporations Permitted to Hold Subsidiaries

Current law. Under present law, an S corporation may not be a member of an affiliated group of corporations. This limitation prevents an S corporation from owning stock in another corporation that possesses 80 percent or more of both the total voting power and value of the outstanding stock of the corporation.

Proposal. An S corporation would be allowed to own any amount, based on voting, value, or both, of the stock of a C corporation. In order to avoid the complexity of the consolidated return regulations, the S corporation parent would not be permitted to file a consolidated return with its subsidiaries.

Administration position. The Administration supports this provision if an acceptable revenue offset is provided. The current law restriction has caused many corporations either knowingly or inadvertently to terminate their S status or to adopt complex corporate structures to circumvent the restriction. The proposal achieves the desired objective of current law by directly preventing S corporations from filing consolidated returns.

6. Elimination of Pre-1983 Earnings and Profits of S Corporations

Current law. Prior to 1983, a corporation electing subchapter S status for a taxable year increased its accumulated earnings and profits to the extent that its undistributed earnings and profits for the year exceeded its taxable income. As a result of changes made in 1982 by the Subchapter S Revision Act, S corporations do not have earnings and profits for any year beginning after 1982. Under current law, a shareholder is required to include in income the pre-1983 accumulated S corporation earnings and profits when it is distributed by the corporation.

Proposal. If a corporation is an S corporation for its first taxable year beginning after December 31, 1991, the accumulated earnings and profits of the corporation (if any) as of the beginning of that year will be reduced by the accumulated earnings and profits that were accumulated in any taxable year beginning before January 1, 1983, for which the corporation was an electing small business corporation under subchapter S. Thus, any remaining earnings and profits of such a corporation would be solely attributable to taxable years for which an S election was not in effect.

Administration position. The Administration does not oppose this provision. We understand that the amounts being eliminated from earnings and profits are generally very small and do not justify the recordkeeping burden they create.

7. Determination of Shareholder's Pro Rata Share Where Disposition of Entire Interest

Current law. In general, the tax items passed through an S corporation to its shareholders are allocated among the shareholders on a per day, per share basis. If a shareholder terminates his or her interest in the corporation, the S corporation, with the consent of all persons who were shareholders at any time during the taxable year, may elect, for purposes of allocating tax items, to close the books of the corporation on the date of the termination of the shareholder's interest in the corporation.

Proposal. The bill would mandate that an S corporation close its books for purposes of allocating items of income on the termination of a shareholder's interest.

Administration position. The Administration supports this provision. It would assure a shareholder terminating his interest in an S corporation that his share of the corporation's income will not be affected by events occurring after the termination of his interest in the corporation.

8. Treatment of Items of Income in Respect of a Decedent Held By an S Corporation

Current law. Income items that would have been receivable by the decedent had he lived, and that are receivable by his estate or beneficiaries, are taxed to the estate or beneficiaries when received and retain the same character they would have had in the hands of the decedent. Such income is referred to as income in respect of a decedent (IRD).

Property which may produce IRD is not entitled to a basis step-up. IRD generated with respect to such property is not subject to income tax when received by the decedent's estate or beneficiaries. Under the partnership regulations, a partnership interest acquired from a decedent does not receive a basis step-up to the extent the fair market value of the interest reflects items of IRD. Thus, the IRD rules cannot be circumvented by contributing an IRD item to a partnership before death and receiving a full fair market value step-up for the partnership interest on the partner's death. There is no parallel provision for S corporation stock, however.

Proposal. The basis step-up at death for S corporation stock would be denied to the extent the fair market value of the stock represents IRD.

Administration position. The Administration supports this provision. It would prevent potential avoidance of the IRD rules by dropping items of IRD (e.g., an installment note) into an S corporation prior to death. The provision would be parallel to the existing rule for determining the basis of a decedent's partnership interest.

B. Accounting Provisions

1. Look-Back Method For Long-Term Contracts

Current law. Income from long-term contracts generally must be reported under the percentage of completion method of accounting (PCM). Under PCM, expected contract profit is recognized ratably, as costs are incurred, over the term of the contract. PCM includes look-back rules intended to compensate for deferral or acceleration of contract income resulting from use of expected (rather than actual) contract profit. Under the look-back rules, if actual contract profit is greater or less than expected profit, the taxpayer must pay, or is entitled to receive, interest. Look-back interest is computed when a contract is completed based on differences between expected and actual contract profits in each taxable year of the contract. It must be recomputed if contract profit changes because additional contract revenues or costs are taken into account after completion. Taxpayers are allowed (but not required) to discount post-completion adjustments to contract revenues and costs back to their value as of contract completion.

The rate used in computing look-back interest is the section 6621 overpayment rate. This overpayment rate equals the applicable Federal short-term rate plus 2 percentage points. The applicable Federal short-term rate is adjusted quarterly by the Internal Revenue Service. For any year of the contract, look-back interest runs from the due date of the return for that year without extensions (March 15 in the case of a calendar year corporate taxpayer) until the due date of the return for the year that the look-back is applied. Thus, to compute look-back interest for a particular year of the contract, a taxpayer is required to use 5 different interest rates for each 12-month period ending after the due date of the return for that year up through the return due date for the year that the look-back method is applied.

Proposal. The bill contains three proposals for simplifying the look-back method. The first two proposals would permit taxpayers to make a combined election under which they are not required to compute look-back interest for a contract, or to recompute look-back interest based on adjustments to contract price and costs, in certain de minimis cases. The third proposal would reduce the number of different interest rates that must be used to compute look-back interest.

If a taxpayer makes the election, the first proposal would provide that look-back interest is not computed for a long-term contract if the amount of deferral or acceleration of income from using estimates is not substantial. Thus, look-back interest is not computed if, for each year of the contract prior to the year of completion, the cumulative taxable income (or loss) from the contract as of the end of that year, determined using estimated contract price and costs, is within 10 percent of the cumulative taxable income (or loss) as of the end of that year using actual contract price and costs.

In addition, if a taxpayer makes the election, the second proposal would provide that look-back interest is not recomputed as a result of an adjustment to contract price or costs in a year after contract completion if the adjustment is not substantial. Thus, look-back interest is not recomputed because of an adjustment in a year after completion if the cumulative taxable income (or loss) from the contract as of the end of that year is within 10 percent of the cumulative taxable income (or loss) from the contract as of the most recent year in which the taxpayer was required to compute or recompute look-back interest (or would have been required to do so if the de minimis test provided by the first proposal had not been met).

The third proposal would generally fix the rate for calculating look-back interest for a 12-month period beginning on the due date of the taxpayer's return at the section 6621 rate for the calendar quarter that includes that date. Thus, in computing look-back interest for a particular contract year, the taxpayer would be required to use only one interest rate (rather than 5 different rates) for each 12-month period ending after the return due date for that year up through the return due date for the year that the look-back method is applied (determined without regard to extensions).

All three proposals apply to contracts completed in taxable years ending after the date of enactment.

Administration position. We support these proposals if an acceptable revenue offset is provided. Each responds to specific taxpayer concerns about the administrative burdens imposed upon taxpayers under current law. In testimony before the Subcommittee on Select Revenue Measures on February 21, 1990, we stated that we did not oppose de minimis rules similar to those that would be provided by the first two proposals. We believe that all three of these proposals would reduce the administrative burden imposed by the look-back method without undermining its purpose.

2. Uniform Cost Capitalization Rules

Current law. Generally, the uniform capitalization rules require taxpayers producing real or tangible property or acquiring property for resale to include in inventory the direct costs of the property and the indirect costs that are allocable to the property. Taxpayers are permitted to use various reasonable methods to determine the indirect costs that are allocable to production or resale activities, including certain simplified allocation methods provided in Treasury regulations.

Proposal. The proposal would authorize (but not require) Treasury to issue regulations providing for a simplified method for determining what part of the costs of administrative, service, or support functions or departments must be capitalized as part of the cost of property that a taxpayer produces or sells. The regulations, if issued, would permit allocation of these costs to production or resale activities by multiplying the total costs of any such function or department for the current taxable year by an historical ratio. The ratio would be the ratio of the total of such function or department's allocable costs that were allocable to property produced or acquired for sale during a "base period" to the function or department's total costs during the base period. The explanation prepared to accompany the proposal states that regulations, if issued, would provide that the base period could begin no earlier than 4 taxable years prior to the taxable year for which the simplified method is used. Although the proposal would be effective for taxable years beginning after the date of enactment, taxpayers could not use the simplified method for any taxable year beginning before Treasury publishes regulations.

Administration position. We do not oppose the proposal because it authorizes rather than requires such regulations. The Administration supports the goal of making compliance with the uniform capitalization rules less burdensome for taxpayers. However, we are not certain that we can devise rules which will adequately protect the fisc from loss due to distortion of income while meaningfully simplifying taxpayers' administrative burdens. We would not expect to prepare regulations under this authority unless we were convinced that the regulations could meet a revenue neutrality constraint.

C. Minimum Tax Provisions

1. Corporate Minimum Tax Depreciation Preference

Current law. In computing the AMT depreciation deduction for personal property, taxpayers are generally required to use the 150 percent declining balance depreciation method over the ADR life of the property set forth in section 168(g). In computing adjusted current earnings (ACE), corporate taxpayers are generally required to compute the ACE depreciation deduction using the straight-line method over the ADR life.

Proposal. Under the proposal, corporate taxpayers generally would be required to use the 120 percent declining balance depreciation method in computing both AMT and ACE depreciation deductions for personal property placed in service in taxable years beginning after December 31, 1990 (using the same ADR recovery periods generally used for both AMT and ACE purposes under current law). The proposal would also permit corporate taxpayers to elect to calculate regular tax depreciation deductions using the same 120 percent declining balance method and recovery periods used in computing AMT and ACE depreciation deductions.

Administration position. We support the proposal provided an acceptable revenue offset is provided. We believe the proposal significantly simplifies the corporate AMT computation. Although the proposal loses revenue, there are some isolated instances in which taxpayers would be disadvantaged by the proposal (e.g., taxpayers with both current and cumulative negative ACE adjustments).

2. Treatment of Built-in Losses for Purposes of the Corporate Alternative Minimum Tax

Current law. For ACE purposes, if a corporation with a net unrealized built-in loss undergoes an ownership change, the adjusted basis of each asset must be restated to its fair market value immediately before the ownership change. This adjustment results in a permanent loss of asset basis for ACE purposes and creates an added complexity for certain taxpayers in computing AMT liabilities.

Proposal. The proposal would repeal the ACE asset basis restatement rule.

Administration position. We support the proposal provided an acceptable revenue offset is provided. Under current law, section 382 limitations apply to net operating losses and net unrealized built-in losses under both the regular tax and AMT systems. However, the ACE asset basis restatement rule results in needless complexity and inconsistency by departing from the general section 382 limitations which apply for regular tax and AMT purposes. The proposal would significantly reduce the recordkeeping requirements for affected taxpayers and provide for consistent application of the section 382 limitations to net unrealized built-in losses under each of the separate regular tax, AMT, and ACE systems.

D. Tax-Exempt Bond Provisions

To be covered in testimony before the Subcommittee on Select Revenue Measures.

E. Revocable Trust Provision

Certain Grantor Trusts Treated As Estates

Current law. Many taxpayers use revocable trusts as substitutes for wills to avoid the costs of probate, for reasons of privacy and other nontax purposes. When a revocable trust becomes irrevocable on the grantor's death and thereafter effectively functions as an estate, it is taxed as a trust and is unable to take advantage of certain provisions of the Code that are available to estates but not trusts.

Proposal. The bill would amend section 7701 by adding a definition of an "estate". Under the provision, an estate is defined to include a pourover revocable trust, or, if there is no will, a trust that is primarily responsible for debts and administration expenses. Such a trust would not be treated as an estate for purposes of determining the trust's personal exemption or taxable year or for gift, estate or generation-skipping tax purposes. Treasury would have regulatory authority to prescribe additional exceptions. Such a trust would be treated as an estate for taxable years that begin within 3 years and 9 months of the decedent's death.

Administration position. The Administration does not oppose this provision of the bill. The purpose of the provision is to eliminate several of the tax disincentives to using funded revocable trusts as substitutes for wills. The bill would simplify planning by reducing the tax considerations in deciding whether to use a revocable trust.

F. Other Provisions Relating to Partnerships

1. Timing Rules for Inclusion and Deduction of Partnership Guaranteed Payments

Current law. Under section 707(a) a partner who engages in a transaction with a partnership other than in his capacity as a partner is treated as if he were not a member of the partnership with respect to the transaction. Examples of such transactions include loans of money or property by the partnership to the partner or by the partner to the partnership, the sale of property by the partner from the partnership, the purchase of property by the partner from the partnership, and the rendering of services by the partnership to the partner or by the partner to the partnership. Transfers of money or property by a partner to a partnership as contributions, or transfers of money or property by a partnership to a partner as distributions, are not transactions within the purview of section 707(a).

Under section 707(c), the payments made by a partnership to a partner for services or for the use of capital (i.e., "guaranteed payments") are considered as made to a person who is not a partner to the extent the payments are determined without regard to the income of the partnership. Guaranteed payments are considered as made to one who is not a member of the partnership only for purposes of section 61(a) (relating to gross income) and section 162(a) (relating to trade or business expenses).

Section 267 sets forth certain timing rules relating to deductions for losses, expenses and interest arising from transactions between related taxpayers. As a general matter, section 267(a)(2) provides that in transactions between related parties, payments are deductible by a taxpayer only when they are includible in the income of the person to whom payment is made. Section 267(e) extends this rule to transactions between partnerships and their partners except with respect to a partnership's guaranteed payments. Instead, a partner must include such payments as ordinary income for his taxable year within or with which ends the partnership taxable year in which the partnership deducted the payments.

Proposal. The bill would defer the deduction of a guaranteed payment by a partnership until the year in which it is includible in the partner's income. Thus, the bill conforms the timing rule for guaranteed payments to the timing rule for payments made to a partner acting in a capacity other than as a member of the partnership.

Administration position. The Administration supports this proposal. It is desirable to have the same timing rule for payments made by a partnership to a partner either as payments made not in the partner's capacity as a partner or as guaranteed payments, since these types of payments can be difficult to distinguish from each other.

2. Closing of Partnership Taxable Year With Respect To Deceased Partner

Current law. A partner reports his share of items of income, gain, loss, deduction, and credit on his return for the year in which or with which the partnership's year ends. The taxable year of a partnership closes with respect to a partner who sells or exchanges his entire interest in the partnership, or whose entire interest in the partnership is liquidated other than by reason of death. Thus, a partner who sells his entire interest reports his share of partnership items for the year that includes the date of sale on his income tax return for the year that includes the date of sale (and not on his return for the year in which the partnership's year would normally have ended). Because the partnership's year does not end by reason of the death of a partner, a decedent-partner's share of partnership items for the partnership year that includes his death is reported on the estate's return rather than on the decedent's final return. However, the partnership's year would close with respect to the decedent-partner if his entire interest is sold pursuant to a buy-sell agreement existing at the time of death. In such a case, the decedent-partner's share of partnership items for the partnership year that includes his death would be reported on his final return rather than the estate's return.

Proposal. The bill would provide that the taxable year of a partnership closes with respect to a partner whose entire interest in the partnership terminates, whether by death, liquidation, or otherwise.

Administration position. We support this proposal. The year closing result should not be dependent on the presence of a buy-sell agreement.

G. Corporate Provision

Clarification of Amount of Gain Recognized by a Securityholder in a Reorganization

Current law. In general, a holder of corporate stock or securities who exchanges them for other stock or securities in a corporate reorganization or "spin-off" does not recognize gain even if the holder realizes gain because the value of the stock or securities received exceeds the holder's basis in the stock or securities given up. This general rule does not apply, however, if the principal amount of securities received exceeds the principal amount of securities given up. In this case, any gain realized on the exchange is recognized up to the fair market value of the excess principal amount. It is not clear how the "principal amount" of a security surrendered or received in a reorganization is measured for this purpose. Under the original issue discount (OID) rules of current law, however, that portion of the stated principal amount of a bond that exceeds the issue price of the bond is treated as unstated interest that is included in income by the holder and deductible by the issuer over the term of the bond.

Proposal. The proposal would coordinate the "excess principal amount" rule with the OID rules of current law. Thus any portion of the stated principal amount that is treated as unstated interest under the OID rules would not be treated as principal for purposes of determining how much gain is recognized in a reorganization. Instead, the issue price of the securities received, and the adjusted issue price of the securities surrendered, would be treated as their principal amount. In contrast to current law, under which the amount of gain recognized is based on the fair market value of the excess principal amount of the securities received, the proposal would not require determination of the fair market value of this excess.

Administration position. We support this proposal. It will provide similar tax treatment for exchanges that are similar in economic substance.

TITLE V. ESTATE AND GIFT TAX PROVISIONS

1. Waiver of Right of Recovery for Certain Marital Deduction Property

Current law. A marital deduction is allowed for estate and gift tax purposes for qualified terminable interest property (QTIP) that passes to a spouse. The property is generally includible in the estate of the spouse beneficiary. The estate of a spouse beneficiary of a QTIP trust has a right of recovery against the person receiving the trust property for estate taxes attributable to the inclusion of the trust in the spouse's gross estate. The right of recovery may be waived by the spouse beneficiary in his or her will.

Proposal. The bill would provide that the right of recovery may be waived by the spouse beneficiary only by a specific reference to section 2207A.

Administration position. The Administration does not oppose this proposal. The proposal does not affect the substantive right of the surviving spouse to waive the right of recovery. By establishing a clear test for what constitutes an effective waiver under section 2207A, the provision should prevent the inadvertent waivers that sometimes occur under present law.

2. Inclusion in Gross Estate of Certain Gifts Made Within Three Years of Death

Current law. Generally, transfers made within 3 years of death are not includible in the transferor's gross estate. However, the transfer within 3 years of death of certain retained rights with respect to previously transferred property causes the entire property to be includible in the transferor's gross estate. This inclusion rule applies to transfers made from a revocable trust within 3 years of the transferor's death. This may cause, among other things, annual exclusion gifts made from the revocable trust during that period to be includible in the transferor's gross estate.

Proposal. The bill would amend section 2038, which deals with revocable transfers, to ensure that transfers made from an individual's revocable trust within 3 years of the individual's death are not includible in the individual's gross estate. The bill would also restate section 2035, which generally deals with the inclusion in the gross estate of property transferred within 3 years of death, for greater clarity without substantive change.

Administration position. The Administration does not oppose this provision of the bill. Funded revocable trusts are created by individuals for a variety of legitimate, nontax planning purposes. The inability to use the revocable trust as a vehicle for making annual exclusion gifts without estate tax exposure is a significant tax disadvantage to the use of such trusts.

3. Definition of Qualified Terminable Interest Property

Current law. A marital deduction is allowed for estate and gift tax purposes for a QTIP passing to a spouse. For property to qualify as QTIP, the beneficiary spouse must have a qualifying income interest for life in the transferred property; i.e., must be entitled to all the income from the property, payable at least annually. Proposed Treasury regulations provide that income accrued or accumulated between the last income distribution date and the date of the spouse's death does not have to be payable to the spouse or the spouse's estate for the spouse to have a qualifying income interest for life. In Estate of Howard, 91 T.C. 329 (1988), rev'd, 910 F.2d 633 (9th Cir. 1990), the Tax Court held that this "stub period" income must be payable to the spouse's estate or be subject to the spouse's general power of appointment for the spouse to have the requisite income interest. Although the Howard decision was reversed on appeal, it is unclear how the Tax Court would rule if the question arises in a case appealable to another circuit.

Proposal. The bill would provide that an income interest would not fail to be a qualifying income interest for life solely because the stub period income is not payable to the spouse's estate or subject to the spouse's general power of appointment. If the marital deduction is allowed, however, such income would be includible in the spouse's estate.

Administration position. The Administration supports this provision of the bill. The codification of the proposed Treasury regulation will eliminate the need for the closing agreement procedure now used by the Internal Revenue Service to permit taxpayers who have relied on the proposed regulation to claim the marital deduction while protecting the government against the potential whipsaw of avoiding subsequent inclusion of the trust property in the spouse's estate on the grounds that the deduction was improperly allowed.

4. Requirements for Qualified Domestic Trust

Current law. Generally, property passing to a noncitizen surviving spouse does not qualify for the marital deduction unless it passes in a qualified domestic trust (QDT). Distributions of principal from such a trust to the surviving spouse are subject to estate tax. When originally enacted, the QDT provisions required that all trustees of a QDT be U.S. citizens or domestic corporations. This provision was retroactively amended twice and ultimately required that the trust must provide that no distributions can be made unless a U.S. trustee has the right to withhold the estate tax imposed on the distribution.

Proposal. Under the proposal, a QDT created prior to the enactment of the 1990 OBRA whose governing instrument requires that all trustees be U.S. citizens or domestic corporations would be treated as satisfying the withholding requirement of current law.

Administration position. The Administration supports this provision of the bill. The trustee requirements for a qualified domestic trust have been amended twice in an attempt to give taxpayers greater flexibility in the choice of trustees while also protecting the government's ability to collect the tax imposed on the trust. We believe that the government's interest is adequately protected if the trust instrument requires that all trustees must be U.S. citizens or domestic corporations. The bill will reduce the number of individuals who will have to redraft wills to comply with the changes that have been made to the trustee requirement for QDTs.

5. Election of Special Use Valuation of Farm Property for Estate Tax Purposes

Current law. Under certain circumstances, a decedent's estate may elect to value real property used in a farm or a trade or business according to its actual use rather than its highest and best use. The election requires, among other things, the filing of an agreement signed by all the qualified heirs consenting to a recapture tax if the special use terminates within 10 years of the decedent's death. An executor who makes the election and substantially complies with the requirements in the regulation for making the election may provide missing information and certain signatures missing from the agreement within 90 days of notification by the Internal Revenue Service.

Proposal. Under the proposal, if the executor makes the special use valuation election and files the agreement regarding the recapture tax, the executor would be permitted to provide any missing information and signatures within 90 days of notification by Internal Revenue Service. This relief would be available without regard to whether the executor substantially complied with the regulatory requirements for making the election.

Administration position. The Administration does not oppose this provision. The special use valuation election is frequently defective because the executor fails to file certain required information or signatures. By expanding the scope of the provision that permits defective elections to be cured, the bill simplifies qualification for the special use valuation in those estates for which it was intended to be available.

TITLE VI. EXCISE TAX PROVISIONS

A. Motor Fuel Excise Tax Provisions

1. Use Tax on Diesel and Aviation Fuel

Current law. Section 4091 imposes a tax on the sale of diesel or aviation fuel by a producer. For this purpose, a wholesaler or a tax-free purchaser (e.g., a State government) is treated as a producer, and a nonexempt use of fuel by a producer is treated as a sale. A person that purchases fuel at a reduced tax rate (e.g., for use in a bus or train) is not treated as a producer. Thus, section 4091 does not impose a tax when a reduced-tax purchaser diverts fuel to a nonexempt use. Section 4041 imposes a back-up use tax on fuel diverted to nonexempt uses, but this tax is redundant in the case of fuel diverted by a tax-free purchaser and does not apply to fuel diverted by a reduced-tax purchaser.

Proposal. The bill would combine the diesel and aviation fuel tax provisions into a revised section 4091. Reduced-tax purchasers would be treated as producers for purposes of the tax imposed by the revised section 4091 and would be liable for the tax when they divert fuel to a nonexempt use. The bill would also reorganize section 4041.

Administration position. We support the proposal. The proposal improves the organizational structure of the diesel and aviation fuel excise tax statutes, making the rules easier to locate and understand. The imposition of tax on fuel diverted to nonexempt uses by reduced-tax producers ensures equivalent treatment of nonexempt uses of diesel and aviation fuel by tax-free and reduced-tax purchasers.

2. Refunds of Diesel and Aviation Fuel Taxes

Current law. Producers (including wholesalers) of diesel or aviation fuel can make tax-free sales to exempt purchasers (e.g., a State government). If, however, a retailer sells diesel or aviation fuel on which tax has been paid to an exempt purchaser, only the exempt purchaser can claim a refund of the tax.

Proposal. The bill would permit the person who paid the tax (generally the wholesaler) to claim the refund if the amount of the tax is repaid to the retailer. (Presumably, the wholesaler would reimburse the retailer only if the retailer sells the fuel to an exempt purchaser at a tax-free price.) This rule would apply only to fuel sold for use in one of the following exempt uses: (1) export, (2) use as supplies for aircraft or vessels, (3) exclusive use by a State or local government, or (4) exclusive use by a nonprofit educational organization. In addition, refunds would be permitted only if the person paying the tax meets such requirements as the Treasury Department may impose under the regulatory authority provided in the bill.

Administration position. We do not oppose the proposal. The proposal significantly simplifies refund procedures for diesel and aviation fuel sold to certain exempt users and conforms those procedures to those applicable to special motor fuels and gasoline. Under the proposal, however, there is a possibility of refund claims by both the wholesaler and the exempt user, and we expect it will be necessary to prescribe regulatory safeguards under the authority provided in the bill. These safeguards, including appropriate certifications by the exempt user, would be designed to prevent an exempt user from claiming a refund if the tax is refunded to the wholesaler.

3. Consolidation of Refund Provisions

Current law. The excise tax imposed on fuel is refunded if the fuel is used for an exempt purpose. Refunds of fuel taxes are currently authorized under three separate Code sections.

Refunds may be claimed annually as a credit on the taxpayer's income tax return. In most cases, taxpayers also have the option of claiming quarterly refunds for the first three quarters of a taxable year. This option is not available, however, with respect to taxes imposed on gasoline and special motor fuel used on a farm for farming purposes. In addition, quarterly refunds are permitted only if the amount of the refund meets a statutory threshold. Different thresholds are prescribed depending on the Code provision authorizing the refund, and claimants may not aggregate refunds authorized under different Code sections (e.g., gasoline refunds authorized under section 6421 and diesel fuel refunds authorized under section 6427) in determining whether the statutory threshold is met.

An expedited refund procedure is available for gasohol blenders.

Proposal. The bill would consolidate the Code provisions authorizing refunds into a single section. This section would prescribe only one refund threshold, and all gasoline and diesel fuel refunds would be aggregated in determining whether this threshold is met. A refund would be permitted for any quarter (including the fourth quarter) in which the cumulative overpayment exceeds $750. Refunds would be permitted under this rule with respect to taxes imposed on gasoline and special motor fuel used on a farm for farming purposes. The special expedited procedure for gasohol blenders would be retained.

Administration position. We do not oppose the proposal. The proposal significantly simplifies the refund procedures by consolidating the rules in a single section and providing uniform threshold and refund procedures. A single standardized refund claim for all fuel taxes reduces administrative burdens imposed on taxpayers that are eligible for refunds of several different types of excise tax.

4. Refunds to Cropdusters

Current law. The excise tax imposed on gasoline or aviation fuel is refunded if the fuel is used for cropdusting. The tax is generally refunded to the farmer; the cropduster is entitled to a refund only if the farmer waives the right to a refund.

Proposal. The bill would eliminate the waiver requirement and provide that only the cropduster is entitled to the refund.

Administration position. We do not oppose the proposal. The waiver requirement is cumbersome and prevents many cropdusters from claiming refunds.

5. Information Reporting on Certain Sales

Current law. When diesel or aviation fuel is sold free of tax or at a reduced tax rate, both the seller and the purchaser are required to file an information return with the Internal Revenue Service.

Proposal. The bill would permit the Treasury Department to issue regulations waiving the information reporting requirement.

Administration position. We support the proposal. The authority to waive the reporting requirement in appropriate cases will allow the Internal Revenue Service to administer the exemptions more efficiently and relieve taxpayers of unnecessary paperwork burdens.

B. Alcohol Excise Tax Provisions

Imported Distilled Spirits Returned to Plant

Current law. When tax-paid distilled spirits that have been withdrawn from bonded premises of a distilled spirits plant are returned for destruction or redistilling, the excise taxes are refunded or credited. Bottled imported distilled spirits are not eligible for this refund or credit because they are originally withdrawn from customs custody and not bonded premises. Additionally, distilled spirits brought into the United States from Puerto Rico are not eligible because they are not withdrawn from bonded premises.

Proposal. The bill would provide that refunds or credits of the tax would be available for all spirits that are returned to the bonded premises of a distilled spirits plant.

Cancellation of Export Bonds

Current law. An exporter that withdraws distilled spirits from bonded warehouses for export or transportation to a customs bonded warehouse without the payment of tax must furnish a bond to cover the withdrawal. The required bonds are canceled "on the submission of such evidence, records, and certification indicating exportation as the Secretary may by regulations prescribe."

Proposal. The bill would allow the bonds to be canceled "if there is such proof of exportation as the Secretary may require." Under this rule, the Treasury Department could permit exporters to satisfy the proof requirement by maintaining records of exportation. Thus, bonds could be canceled without submission of proof of exportation.

Location of Records of Distilled Spirits Plant

Current law. Proprietors of distilled spirits plants are required to maintain records and reports relating to their production, storage, denaturation, and processing activities on the premises where the operations covered by the records are carried on.

Proposal. The bill would permit proprietors to maintain records and reports at locations other than the plant premises. As under current law, the records and reports would be required to be available for inspection by the Treasury Department during business hours.

Transfers from Brewery to Distilled Spirits Plant

Current law. A distilled spirits plant may receive tax-free beer on its bonded premises for use in the production of distilled spirits. This rule applies only if the beer is produced on contiguous brewery premises.

Proposal. The bill would provide an exemption from excise tax, subject to Treasury regulations, for beer removed to a distilled spirits plant from any brewery for use in the production of distilled spirits. The bill would also authorize the receipt of such beer by a distilled spirits plant.

Sign Not Required for Wholesale Dealers

Current law. Wholesale liquor dealers are required to post a sign identifying the firm as such. Failure to do so is subject to a penalty.

Proposal. The bill would repeal the requirement that a sign be posted.

Refund on Returns of Merchantable Wine

Current law. Excise tax paid on domestic wine that is returned to bond as unmerchantable is refunded or credited, and the wine is once again treated as wine in bond on the premises of a bonded wine cellar.

Proposal. The bill would permit a refund or credit in the case of all domestic wine returned to bond, whether or not unmerchantable.

Increased Sugar Limits for Certain Wine

Current law. Natural wines may be sweetened to correct high acid content. If the amount of sugar used exceeds the applicable limitation, however, the wine must be labeled "Substandard." For most wines the limitation is exceeded if sugar constitutes more than 35 percent (by volume) of the combined sugar and juice used to produce the wine. Up to 60 percent sugar may be used in wine made from loganberries, currants, and gooseberries.

Proposal. The bill would provide that up to 60 percent sugar could be used in any wine made from juice, such as cranberry or plum juice, with an acid content of 20 or more parts per thousand.

Beer Withdrawn for Embassy Use

Current law. Imported beer, wine, and distilled spirits to be used for the family and official use of foreign governments, organizations and individuals may be withdrawn from customs bonded warehouses without payment of excise tax. A similar rule applies to domestically produced wine and distilled spirits. There is no similar exemption for domestic beer withdrawn from a brewery or entered into a bonded customs warehouse for the same authorized use.

Proposal. The bill would provide an exemption for domestic beer similar to that available for domestically produced wine and spirits. The exemption would be subject to Treasury's regulatory authority.

Beer Withdrawn for Destruction

Current law. Beer removed from a brewery for destruction must be tax-paid rather than withdrawn without payment of excise tax.

Proposal. The bill would provide an exemption from tax for removals for destruction, subject to Treasury regulations.

Drawback on Exported Beer

Current law. A domestic producer that exports beer may recover the tax (receive a "drawback") found to have been paid on the exported beer upon the "submission of such evidence, records and certificates indicating exportation" required by regulations.

Proposal. The bill would allow a drawback of tax paid "if there is such proof of exportation as the Secretary may by regulations require." Under this rule, the Treasury Department could permit exporters to satisfy the proof requirement by maintaining records of exportation. Thus, tax could be refunded without submission of proof of exportation.

Imported Beer Transferred in Bulk to Brewery

Current law. Imported bulk and bottled beer is subject to tax when removed from customs custody.

Proposal. The bill would provide that, subject to Treasury regulations, beer imported in bulk containers could be withdrawn from customs custody and transferred in bulk to a brewery without payment of tax. Under this provision, the proprietor of the brewery to which the beer is transferred is liable for the tax imposed on the withdrawal from customs custody and the importer would be relieved of liability.

Administration Position on Alcohol Excise Tax Provisions. We support these proposals.

Until 1980, the method of collecting alcohol excise taxes required the regular presence of Treasury Department inspectors at alcohol production facilities. In 1980, the method of collecting tax was changed to a bonded premises system under which examinations and collection procedures are similar to those used in connection with other Federal taxes.

A number of proposals conform reporting and recordkeeping requirements to the current collection system. These changes will allow the Bureau of Alcohol, Tobacco, and Firearms to administer alcohol excise taxes more efficiently and relieve taxpayers of unnecessary paperwork burdens.

Other proposals expand the circumstances in which the Code permits tax-free removals of alcoholic beverages (or allows a credit or refund of tax on a return to bonded premises). These changes are also consistent with the current collection system and will not jeopardize the collection of tax revenues. In a number of cases, the changes will eliminate inappropriate disparities in the treatment of different types of alcoholic beverages. In addition, several of these proposals will provide producers with additional options in complying with environmental and other laws that regulate the destruction and disposition of these products.

The remaining proposals (i.e., the repeal of the sign requirement and the increased sugar limits for certain wine) repeal or revise outmoded provisions. We do not believe the adoption of these proposals will have adverse consequences.

C. Other Excise Tax Provisions

1. Waiver of Registration Requirement

Current law. The Code exempts certain types of sales (e.g., sales for use in further manufacture, sales for export, and sales for exclusive use by a State or local government or a nonprofit educational organization) from excise taxes imposed on manufacturers and retailers. These exemptions generally apply only if the seller, the purchaser, and any person to whom the article is resold by the purchaser (the second purchaser) are registered with the Internal Revenue Service. The Internal Revenue Service can waive the registration requirement for the purchaser and second purchaser in some but not all cases.

Proposal. The bill would authorize the Treasury Department to specify the cases in which the registration requirement applies to purchasers and second purchasers. Exempt sales to unregistered purchasers and second purchasers would be permitted in all other cases.

Administration position. We support the proposal. The authority to waive the registration requirement in appropriate cases will allow the Internal Revenue Service to administer the exemptions more efficiently and relieve taxpayers of unnecessary paperwork burdens.

2. Deadwood--Piggyback Trailers and Deep Seabed Minerals

Current law. The Code includes a provision relating to a temporary reduction in the tax on piggyback trailers sold before July 18, 1985, and provisions relating to the tax on the removal of hard minerals from the deep seabed before June 28, 1990.

Proposal. The bill would repeal these provisions.

Administration position. We support the proposal. Continued retention of these deadwood provisions is unnecessary.

TITLE VII. ADMINISTRATIVE PROVISIONS

A. Administrative Provisions

1. Employment Tax Reporting for Household Employees

Current law. Household employers who pay cash wages of $50 or more per quarter must withhold social security taxes (including Medicare taxes) from wages paid to the employee during the quarter. The withheld taxes, together with the portion of the tax paid by the employer, are paid with a quarterly FICA return on Form 942. Household employers who pay cash wages of $1,000 or more in any calendar quarter in the current year or the preceding year are subject to Federal unemployment taxes and must file an annual FUTA return on Form 940 or Form 940EZ. Quarterly deposits are required if certain FUTA liability thresholds are met. Although wages of household employees are not subject to mandatory income tax withholding, an employer and employee may enter into a voluntary withholding agreement. In that case, withheld income taxes are reported and paid on the quarterly return filed for FICA purposes. After the end of each calendar year, household employers must provide copies of Form W-2 (Wage and Tax Statement) to each employee and must transmit all Forms W-2 to the Social Security Administration with Form W-3 (Transmittal of Income and Tax Statements).

Household employers subject to FUTA are typically required to file quarterly state unemployment tax returns as well.

Proposal. Household employers would report all FICA and FUTA taxes and any withheld income taxes ("domestic service employment taxes") on a schedule to Form 1040. No quarterly payments or deposits would be required, but domestic service employment taxes would be counted in determining the employer's estimated tax penalty. Thus, a household employer would be required either to make payments of estimated taxes or to increase the rate of withholding on his own wages to cover his liability for domestic service employment taxes.

To make simplified annual reporting possible, the quarterly FICA threshold would be changed to an annual threshold of $300.

In addition, the Secretary would be granted the authority to enter into agreements with the states which would allow the Internal Revenue Service, acting as agent for the states, to collect state unemployment taxes in the same manner.

Administration position. The Administration supports the proposal. The proposal should provide substantial simplification and increased compliance.

Current law requires employers of household employees to file 5 Federal returns annually in addition to forms such as W-3 and W-2. State unemployment reports must be separately filed on a quarterly basis, often to remit quite small liabilities ($7-8 annually). Household employers are frequently unaware of and do not comply with such requirements. By incorporating Federal return requirements into Form 1040, the compliance burden should be eased and household employers will be reminded of their filing responsibilities. While State participation in the Form 1040 filing system would be voluntary, many states may find the system cost effective to collect the relatively small sums involved.

We recommend that the proposal be made effective for remuneration paid after December 31, 1992, in order to allow the Internal Revenue Service to prepare forms and inform taxpayers about the new filing system. In addition, we recommend that the return due date provision be clarified to make certain that the schedule is not due earlier than the date of the Form 1040 if the taxpayer utilizes an extension to file.

2. Uniform Penalty Provisions to Apply to Certain Pension Reporting Requirements

Current law. Any person who fails to file an information report with the Internal Revenue Service on or before the prescribed filing date is subject to penalties for each failure. The general penalty structure provides that the amount of the penalty is to vary with the length of time within which the taxpayer corrects the failure, and allows taxpayers to correct a de minimis number of errors and avoid penalties entirely. A different, flat-amount penalty applies for each failure to provide information reports to the Internal Revenue Service or statements to payees relating to pension payments.

Proposal. The bill would incorporate into the general penalty structure the penalties for failure to provide information reports relating to pension payments.

Administration position. We support this proposal because conforming the information-reporting penalties that apply with respect to pension payments to the general information-reporting penalty structure will simplify the overall penalty structure through uniformity and provide more appropriate information-reporting penalties with respect to pension payments.

3. Use of Reproductions of Returns Stored in Digital Image Format

Current law. Under section 6103(p)(2), the Internal Revenue Service is required to provide a reproduction of a return upon request from a person entitled to disclosure of the return, and may provide return information to such a person through a variety of media. Reproductions so provided have the same legal status as the original return and may be admitted into evidence in judicial or administrative proceedings.

Proposal. The Code would be amended to clarify that the Internal Revenue Service may discharge its obligations to persons seeking disclosure of returns by furnishing them with reproductions produced through digital image technology. Such technology will eventually enable the Internal Revenue Service to store returns in digital image form and realize significant costs savings. The cost of storing, retrieving and copying tax returns is today about $42 million annually. The bill also would require the Comptroller General to conduct a study of available digital image technology for the purpose of determining the extent to which reproductions of documents stored using that technology accurately reflect the data on the original document and the appropriate period for retaining the original document.

Administration position. We support this proposal. In addition to cost savings, the use of digital image technology will speed the retrieval of return information for use by the Internal Revenue Service in resolving taxpayer inquiries, conducting examinations and litigating tax issues. To ensure that accurate and legible document images are created, the Internal Revenue Service will institute strict quality control standards. As provided in section 6103 generally, taxpayer information will continue to be protected from unauthorized disclosure.

4. Repeal of Tax Shelter Registration Rules

Current law. The Code requires the registration of tax shelters with the Internal Revenue Service and imposes penalties for failure to comply with the registration requirements. The provisions were adopted in 1984 to enable the Internal Revenue Service to identify and audit more effectively tax shelter investments that had proliferated during the early 1980s. Due to changes in the tax laws since 1984, tax shelter activities have declined substantially. On the other hand, partnerships with over 500 investors have almost doubled. The tax shelter registration provisions are particularly cumbersome for such widely held partnerships. Organizers and sellers of potentially abusive tax shelters are required to keep lists of investors and to make them available to the Internal Revenue Service on request.

Proposal. The tax shelter registration rules would be repealed. Current law rules applicable to organizers and sellers of potentially abusive tax shelters would be retained.

Administration position. The Administration supports this provision. The steep decline in the number of tax shelters being marketed has greatly reduced the amount of information being provided under the tax shelter registration rules. The information is no longer sufficiently useful to justify the paperwork burdens it creates both for taxpayers (particularly widely held partnerships) and the Internal Revenue Service.

5. Repeal Authority to Disclose Whether Prospective Juror Has Been Audited

Current law. Section 6103(h)(5) provides that in connection with any civil or criminal tax case the Secretary (or his delegate) must disclose, upon written request from either party to the lawsuit, whether an individual who is a prospective juror has or has not been subject to any audit or other tax investigation by the Internal Revenue Service. In United States v. Hashimoto, 878 F. 2d 1126 (9th Cir. 1989), it was held that the defendant had an absolute right to information about prospective jurors under section 6103(h)(5), and that trial court rulings that had the effect of denying the defendant this right constituted reversible error. Following the Hashimoto decision, the Internal Revenue Service has received from defendants an escalating number of requests for information under section 6103(h)(5).

Proposal. The bill would repeal the authority to disclose whether prospective jurors have been audited.

Administration position. We support the repeal of section 6103(h)(5). Information regarding prior tax investigations can be elicited from prospective jurors in voir dire questioning, without resort to the cumbersome, time consuming and sometimes harmful mechanism of section 6103(h)(5) as interpreted in Hashimoto.

6. Repeal TEFRA Audit Rules For S Corporations

Current law. An S corporation generally is not subject to income tax on its taxable income. Instead, it files an information return and the shareholders report their pro rata share of the S corporation's income and deductions on the shareholders' tax return. The Subchapter S Revision Act of 1982 generally made the TEFRA partnership audit and litigation rules applicable to S corporations. These rules require the determination of all "Subchapter S items" at the corporate, rather than the shareholder, level. These rules also require a shareholder to report all Subchapter S items consistently with the corporation's information return or to notify the Internal Revenue Service of any inconsistency.

Proposal. The bill would repeal the unified audit procedures for S corporations, but retain the requirement that shareholders report items in a manner consistent with the corporation's return.

Administration position. We support repeal of the TEFRA audit rules for S corporations. The vast majority of both existing and newly formed S corporations are expected to qualify for the small S corporation exception from the unified audit and litigation provisions. Accordingly, a unified audit procedure, with the intendant necessity for the Internal Revenue Service and the courts to prescribe special rules and procedures, is unnecessary and often confusing for those S corporations subject to the provision.

It would be desirable before final enactment to clarify the effect of the provision on pending proceedings and years before the effective date as to which no proceeding is pending. The provision also should be effective for taxable years ending after a given date, rather than for taxable years starting after a given date. The precise date an S corporation's first taxable year commences may be unclear in certain cases.

7. Limitations on Assessment and Collection

Current law. Taxpayers who have invested or that have an interest in passthrough entities such as partnerships, S corporations and trusts currently are asserting that the Internal Revenue Service cannot make adjustments to their returns with open statutes of limitations when the adjustments asserted arise from distributions from passthrough entities for which the statutes of limitations have expired. Recent court cases have given support to taxpayers. See Kelley v. Commissioner, 977 F.2d 756 (9th Cir. 1989), in which the Ninth Circuit held that an extension of time for assessing tax for the 1980 year executed by a shareholder of an S corporation did not permit an S corporation adjustment to the shareholder's return if the statute of limitations with respect to the S corporation had expired, and Fendell v. Commissioner, 906 F.2d 362 (8th Cir. 1990), in which the Eighth Circuit held that the Commissioner cannot adjust individual income tax returns for 1975 and 1977 with open statutes of limitations, when the adjustments arise from the distributions to a beneficiary of income from a complex trust for which the statute of limitations has expired.

Proposal. The proposal would clarify that the running of the statute of limitations begins with the filing of the return of the taxpayer whose liability is in question, rather than the filing of the return of another person (such as a partnership, S corporation, or trust) from which the taxpayer received some item of income, gain, loss, deduction, or credit. The proposal would not affect the statute of limitations applicable to an entity subject to the TEFRA unified audit rules.

Administration position. We support this clarification, because it would avoid years of protracted and costly litigation over collateral matters.

B. Tax Court Provisions

1. Overpayment Determinations of the Tax Court

Current law. The Tax Court has jurisdiction to order the refund of an overpayment determined by the Court, plus interest, if the Internal Revenue Service fails to refund such overpayment and interest within 120 days after the Court's decision becomes final. Whether such an order is appealable is uncertain. In addition, whether the Tax Court has jurisdiction over the validity or merits of certain credits or offsets (e.g., student loans, child support, etc.) made by the Internal Revenue Service which serve to reduce or eliminate the refund to which the taxpayer was otherwise entitled is unclear.

Proposal. The bill would clarify that these orders are appealable in the same manner as a decision of the Tax Court. The bill would also clarify that the Tax Court does not have any jurisdiction over the validity or merits of any credit or offset made by the Internal Revenue Service which would serve to reduce or eliminate the refund to which the taxpayer was otherwise entitled.

Administration position. We support the bill's clarification of current law.

2. Awarding of Administrative Costs

Current law. Any person who substantially prevails in any action brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty may be awarded reasonable administrative costs incurred before the Internal Revenue Service and reasonable litigation costs incurred in connection with any court proceeding. No time limit is specified for the taxpayer to apply to the Internal Revenue Service for an award of administrative costs. In addition, no time limit is specified for a taxpayer to appeal to the Tax Court an Internal Revenue Service decision denying an award of administrative costs. Finally, the procedural rules for adjudicating denial of administrative costs are unclear.

Proposal. The bill would provide that a party who seeks an award of administrative costs must apply for such costs within 90 days of the date on which the party was determined to be a prevailing party. The bill would also provide that a party who seeks to appeal a denial by the Internal Revenue Service of an administrative costs award must petition the Tax Court within 90 days after the date that the Internal Revenue Service mails the denial notice. The bill would clarify that dispositions of administrative cost petitions by the Tax Court are reviewed in the same manner as other decisions of the Tax Court.

Administration position. We support clarifying the procedures for applying for a cost award and appealing from a denial of such an award.

3. Redetermination of Interest Pursuant to Motion

Current law. Section 7481(c)(4) provides that a taxpayer may seek a redetermination of interest after certain decisions of the Tax Court by filing a petition with the Tax Court.

Proposal. The bill would substitute a motion for a petition for this purpose.

Administration position. We support this clarification because it serves both to eliminate possible confusion and conforms the terminology of section 7481(c)(4) to that of analogous sections, such as section 6512(b)(2), which directs the taxpayer to invoke the Tax Court's jurisdiction in other types of supplementary proceedings by motion.

4. Application of Net Worth Requirement for Awards of Litigation Costs

Current law. In the Federal courts, including the Tax Court and the Customs Court, a taxpayer who prevails may be awarded reasonable litigation costs, including attorneys' fees. The Code provides that the prevailing party must meet the net worth requirements of section 2412(d)(2)(B) of title 28, United States Code. The provision is silent as to whether the net worth requirement relates to trusts and estates.

Proposal. The bill would clarify that the net worth requirement applies to trusts (determined as of the last day of the taxable year involved in the proceeding) and estates (determined as of the date of the decedent's death). The bill also would provide that individuals who file a joint tax return are treated as one individual for purposes of computing the net worth limitations. An exception to this rule would be provided for innocent spouses.

Administration position. We support clarifying that the net worth requirement applies to trusts and estates and that individuals filing a joint return are treated as one individual for purposes of the net worth requirement.

C. Cooperative Agreements

Permit IRS to Enter Into Cooperative Agreements With State Tax Authorities

Current law. The Internal Revenue Service is generally not authorized to use funds appropriated for Federal tax administration to provide services to non-Federal agencies even if the cost is reimbursed.

Proposal. The Internal Revenue Service would be authorized to enter into reimbursable agreements with the states to enhance joint tax administration. Reimbursable costs would include such items as data processing, software development and hardware acquisition as well as personnel costs, travel, and visual items involved in providing a service.

Administration position. We support authorizing the Internal Revenue Service to enter into reimbursable agreements with the states for these purposes. The proposal could lead to joint Federal-state programs which would simplify and shorten return preparation time for taxpayers and reduce processing costs at both the Federal and state level.

B. ANALYSIS OF CERTAIN PROVISIONS OF H.R. 2775, RELATING TO ADDITIONAL TAX SIMPLIFICATION

TITLE I. INDIVIDUAL TAX PROVISIONS

1. Repeal "Wee Tots" Credit

Current law. The earned income tax credit (EITC) is a refundable tax credit available to low-income workers with children. The EITC consists of (i) a basic credit, which is adjusted for family size, (ii) a health credit, and (iii) a supplemental credit for workers with a child under age one (the "young child" or "wee tots" credit). The 1990 OBRA increased the basic credit rate and added the family size adjustment, the health credit, and the young child credit.

For 1991, the basic EITC rate is 16.7 percent of the first $7,140 of earned income for a worker with one child and 17.3 percent of that amount for a worker with two or more children. A worker with one child may receive a basic EITC of up to $1,192. For a worker with two or more children, the maximum basic credit is $1,235.

The young child credit increases the basic EITC by 5 percentage points. The maximum young child credit for 1991 is $357. A taxpayer who has a child under age one and claims the supplemental young child credit may not take that child into account in determining the amount of the dependent care tax credit or the exclusion for employer-provided dependent care assistance.

For 1991, the basic EITC and the young child credit are phased out for taxpayers with adjusted gross income (or, if greater, earned income) of more than $11,250. The basic EITC and the young child credit are not available to taxpayers with adjusted gross income (or, if greater, earned income) of approximately $21,245 or more.

In 1992, the basic EITC rate will increase to 17.6 percent for a worker with one child and 18.4 percent for a worker with two or more children. The corresponding percentages for 1993 are 18.5 percent and 19.5 percent. For 1994 and future years, the percentages are 23 percent and 25 percent.

Proposal. The bill would repeal the young child credit and would increase the family size adjustment to the basic EITC. These changes would be effective for taxable years beginning after December 31, 1991. For workers with two or more children, the basic EITC would be 21.7 percent in 1992, 22.8 percent in 1993 and 28.3 percent in 1994 and future years.

Administration position. The Administration opposes repeal of the young child credit. Repeal of the young child credit would be contrary to the Administration's policy on child care. Further, the repeal of the young child credit and the increase in the family size adjustment would significantly change substantive law. The proposal would change the amount of the EITC received by nearly 7 million families (or over half of all EITC recipients). As a consequence, this proposal cannot be viewed merely as simplification. Finally, the proposal as introduced is estimated by the Office of Tax Analysis to lose almost $3 billion over the budget period. While we understand that such a revenue loss was not intended, this proposal simply does not belong on the simplification agenda.

In 1989, the President proposed a number of measures designed to increase the child care choices available to working families. Among the proposals was a new, refundable tax credit of up to $1,000 for each dependent child under age 4. The proposal was targeted to the neediest families: those with both low income and preschool children. A study by the Congressional Research Service examined the child care expenditures of working mothers of preschool children. According to this study, child care expenditures constituted about 6 percent of family income for families that paid for child care. However, for low-income families that paid for child care, child care expenditures constituted about 20 percent of income. Moreover, young children generally require more extensive child care services than older children, who may be in a school setting for much of the day. A study for the Department of Health and Human Services by Dr. Lorelei Brush found that the most significant predictor of child care expenditures was the number of preschool children.

The young child credit, which was enacted as part of the 1990 OBRA, serves the same goals as the President's original proposal. It recognizes that child care costs for infants are generally higher than costs for older children. The young child credit also enhances families' options to have one parent stay at home to care for a child during its first, critical months of life.

The proposal would decrease the EITC received by about 1 million low-income families with infants, even taking into account the increase in the family size adjustment.

The Administration would be willing to consider a revenue neutral simplification of the EITC which would reduce the complications arising from current interaction requirements. This approach would retain the basic policy decisions made last year and would also simplify computation of the credit.

2. Rollover of Gain on Sale of Principal Residence: Rules Relating to Use Prior to Divorce

Current law. The determination of whether a taxpayer uses property as a residence, and of whether a taxpayer uses a residence as his or her principal residence, is made based on all the facts and circumstances. No safe harbors are provided.

Proposal. The proposal would create a limited safe harbor for taxpayers whose residence is sold pursuant to a divorce or marital separation. If a taxpayer in such a situation used the residence as his or her principal residence at any time during the 2-year period prior to the sale, the residence would be treated as the taxpayer's principal residence at the time of the sale for purposes of section 1034.

Administration position. The Administration does not oppose this provision. The provision establishes a special rule benefitting taxpayers who move out of a principal residence within 2 years before the residence is sold in connection with a divorce or separation. Although broadly drafted, this special rule should ease the administration of section 1034 in cases of divorce or separation, and will ordinarily have equitable results. The rule is particularly justified where a taxpayer is required by a court order issued in connection with a divorce or separation to move out of a principal residence before the residence is sold.

3. De Minimis Rule for Passive Losses

Current law. The passive activity rules of section 469 limit the allowability of deductions and credits from passive activities of individuals, estates, trusts, and certain corporations. In general, the rules provide that deductions from a taxpayer's passive activities are allowed only to the extent of the income from those activities. The excess deductions (the passive activity loss) may not be used to offset income from wages, portfolio investments, and active trades or businesses. Similarly, credits from a taxpayer's passive activities are allowed only to the extent of the tax liability attributable to the net income from those activities, and the excess credits (the passive activity credit) may not be used to offset tax liability attributable to other types of income. The deductions and credits that these rules disallow for a taxable year are carried forward and treated as deductions and credits from passive activities in the following taxable year.

Special rules apply when there has been a complete disposition of a taxpayer's interest in a passive activity. Under these rules, the taxpayer's current-year and suspended losses are generally allowed in full in the year of the disposition.

Special rules also apply to rental real estate activities. Passive activities are defined to include all rental activities, but natural persons (and certain estates) may deduct up to $25,000 per year for losses from certain rental real estate activities (or claim the deduction equivalent in credits from those activities). This exemption from the passive activity limitations applies only to losses and credits from activities in which the taxpayer actively participates, and the exemption is phased out for taxpayers with adjusted gross incomes between $100,000 and $150,000.

Proposal. The bill would provide a de minimis exception from the passive activity limitations for natural persons (and certain estates). Under this exception, the taxpayer's losses from passive activities would be allowed for any taxable year in which the passive activity loss does not exceed $200. The exception would not apply if the $200 threshold is exceeded; in that case, the passive activity limitations would apply in the same manner as under current law.

The rules concerning eligibility for the exception would be similar to the eligibility requirements for the rental real estate exception, but would not include an adjusted gross income limitation. Thus, the exception would apply only to natural persons and to estates during taxable years ending less than 2 years after the death of the decedent. In addition, the threshold is reduced to $100 for a married individual filing a separate return, and the exception would not be available to married couples who live together and file separate returns.

In general, the $200 threshold limitation would be applied by computing the taxpayer's passive activity loss under current-law rules. Thus, suspended deductions from passive activities would be taken into account. Losses that are allowable under the rental real estate exception would also count against the $200 threshold because that exception applies after the computation of the passive activity loss.

A special rule would apply to items from publicly traded partnerships. Under this rule, a taxpayer's losses from a publicly traded partnership would not qualify for the de minimis exception and would not be counted against the $200 threshold.

Administration position. We are not opposed to the objective of providing relief from the burden of accounting for de minimis passive losses, but we have concerns about the mechanics of this proposal.

Under the proposal, a taxpayer must compute the passive activity loss, applying all the rules of current law, to determine whether the exception applies. Thus, taxpayers qualifying for the exception are relieved only from the burdens of reporting the already-computed limitation on their returns and retaining a record of the suspended deductions for use in future years.

The proposal would eliminate the need for computations allocating suspended deductions among multiple activities in cases to which the de minimis exception applies. There are very few instances, however, in which (1) the passive activity loss does not exceed $200 and (2) the suspended deductions are attributable to multiple activities.

TITLE II. TAX-EXEMPT BOND PROVISIONS

To be covered in testimony before the Subcommittee on Select Revenue Measures.

TITLE III. ADMINISTRATIVE PROVISIONS

1. Payroll Tax Deposit Requirements

Current law. The Code provides that the Secretary may establish the mode or time for collecting any tax if not specified in the Code. Pursuant to this authority, Treasury regulations have generally established a system under which employers deposit FICA taxes and income taxes withheld from employees' wages. The frequency with which deposits must be made under this system increases as the amount of the deposit liability increases. Taxes withheld under the Railroad Retirement Tax Act and the backup withholding provisions of the Code are subject to similar requirements.

Employers may be required to deposit taxes under this system up to 8 times per month if the amount of the deposit liability equals or exceeds $3,000. These deposits must be made within 3 banking days after the end of the eighth-monthly period to which the taxes relate. Monthly or quarterly deposits are required where the amount of the deposit liability is less than $3,000.

The Code also requires employers that are subject to the eighth-monthly system under the Treasury regulations to deposit taxes by the close of the next banking day after any day on which they cumulate an amount to be deposited of at least $100,000 (regardless of whether that day is the last day of an eighth-monthly period).

Proposal. The deposit schedule under the current payroll tax deposit system would be altered. The current eighth-monthly system would be replaced with a system based on semi-weekly periods. Generally, taxes accumulated on Saturday, Sunday, Monday, or Tuesday would be deposited on Friday. Taxes accumulated on Wednesday, Thursday, or Friday would be deposited on Tuesday. If banks were closed on the deposit day, the deposit would be due on the next banking day. As under current law, accumulations of $100,000 or more within a semi-weekly period would be required to be deposited on the next banking day. The underdeposit tolerance under the current system for employers that must make next-day or eighth-monthly deposits would be retained, but would be reduced from 5 percent of the required deposit to the greater of 2 percent or $150. The current category of employers that must make monthly deposits would be eliminated. Those with required deposits of $3,500 or less per calendar quarter would generally be switched to quarterly payments, while the rest would be subject to semi-weekly deposits.

Administration position. The Administration does not oppose this proposal. It would simplify employers' tax deposit obligations by replacing the current system with a system that is generally clearer, more predictable and easier to understand.

2. Estimated Tax Payment Rules for Small Corporations

Current law. A corporation is subject to an addition to tax for any underpayment of estimated tax. A corporation does not have an underpayment of estimated tax if it makes 4 timely estimated tax payments each equal to at least 22.5 percent of its tax liability for the current taxable year. In addition, a corporation that is not a "large corporation" may avoid the addition to tax if it makes 4 timely estimated tax payments each equal to at least 25 percent of its tax liability for the preceding taxable year, so long as the preceding year was not a short taxable year and the corporation filed a return showing a tax liability for such year. The only estimated tax payment that a large corporation may base on its tax liability for the preceding taxable year is the corporation's estimated tax payment for the first quarter of its current taxable year. A large corporation is one that had taxable income of $1 million or more for any of the 3 preceding taxable years.

Proposal. The bill would provide that a small corporation with no tax liability in the preceding taxable year may avoid the addition to tax if it makes 4 timely estimated tax payments each equal to at least 25 percent of its tax liability for the second preceding taxable year. The second preceding year, like the first preceding year, must not have been a short year and the corporation must have filed a return for each of these 2 years.

A small corporation would owe no estimated tax for the current taxable year, therefore, if it met these requirements and showed no tax liability on its return for the second preceding year.

A large corporation would be permitted to use this expanded safe harbor with respect to its estimated tax payment for the first quarter of its current taxable year.

Administration position. We do not support this proposal. The broadening of the safe harbor would provide targeted relief at a significant revenue cost, and in any event is probably not appropriate for large corporations.

3. Large Corporate Underpayments

Current law. Section 6621(c) was added by the 1990 OBRA to impose a rate of interest on large underpayments of tax by corporations that is 2 percentage points higher than the rate of interest that is generally charged on underpayments of tax. This higher rate of interest does not apply until 30 days after the Internal Revenue Service sends the taxpayer a letter or notice that indicates that the Internal Revenue Service believes there has been an underpayment of tax, and a letter or notice is disregarded for this purpose if the taxpayer makes a payment within 30 days equal to the amount shown as due on the letter or notice.

A large corporate underpayment of tax is defined as any underpayment of more than $100,000 of tax for a taxable period. The existence of a large corporate underpayment is determined by comparing the amount of tax that was timely paid to the amount of tax that is eventually determined to be the taxpayer's liability for the period (e.g., by agreement with the taxpayer or by a court), without regard to the amount of the underpayment that was asserted in the letter or notice that started interest running at the higher rate. Thus, under current law, if a taxpayer fails to respond to a letter or notice asserting a small amount of tax within 30 days, and the Internal Revenue Service later asserts a much larger underpayment for that taxable period, then the taxpayer owes interest at the higher rate on the entire underpayment from the date that is 30 days after the first letter or notice was sent.

Proposal. The bill would provide that a letter or notice that asserts an underpayment of $100,000 or less would not start the running of interest at the higher section 6621(c) rate.

Administration position. We do not oppose this proposal provided an acceptable revenue offset is provided. It eliminates the possibility that a notice raising a relatively small issue may commence the running of interest at the higher 6621(c) rate with respect to a much larger deficiency assessed months or years later. We note that limiting the scope of the proposal to letters or notices asserting a smaller underpayment (perhaps in the $25,000 to $50,000 range) could preserve most of the benefit of the proposal while reducing the revenue loss from the proposal.

TITLE IV. ESTATE AND GIFT TAX PROVISION

Include Fractional Share of Property Qualifying for the Marital Deduction in the Gross Estate

Current law. Generally, property passing to a spouse qualifies for a gift or estate tax marital deduction. In the case of qualified terminable interest property or property passing in a general power of appointment trust that qualifies for the marital deduction, the beneficiary spouse must have the right to receive the income from all or a specific portion of the trust property. In addition, in a general power of appointment trust, the spouse must have a general power of appointment over all or a specific portion of the trust property. Treasury regulations define a specific portion as a fractional or percentage share. However, courts have held with regard to both the income interest and the general power of appointment over principal that a specific portion includes a fixed pecuniary amount. See Northeastern Pennsylvania National Bank and Trust Co. v. U.S., 387 U.S. 213 (1967); Estate of Alexander v. Commissioner, 82 T.C. 34 (1984).

Proposal. The bill would provide that a specific portion means a fractional or percentage share.

Administration position. The Administration supports this provision of the bill. The marital deduction is a tax deferral mechanism that permits a full deduction for gift and estate tax purposes for property passing to a spouse on the assumption that the full value of the property will be subject to transfer tax in the surviving spouse's estate; i.e., the property will be taxed only once in the marital unit. Interpreting "specific portion" in the marital deduction provisions to include a pecuniary amount may permit appreciation in the value of the property between the death of the first spouse and the death of the second spouse to escape transfer tax. Such a result is inconsistent with the purpose and assumptions of the marital deduction. We believe that the position in the regulations which is codified by the bill is correct tax policy.

CONCLUSION

H.R. 2777 provides a substantial start toward simplifying our tax laws. Certain provisions of H.R. 2775 should be seriously considered. Work remains to perfect these proposals and to make certain they meet revenue constraints. However, the beginning made by these bills is encouraging. Mr. Chairman, we look forward to working with you and Mr. Archer, the members of this Committee, and your staffs to complete the job. I will be pleased to answer any questions you may wish to ask.

REVENUE ESTIMATES OF H.R. 2777 AND H.R.2775
BY TITLE

	(millions) 1992	1992-96
H.R. 2777		
Title I -- Individual tax provisions	-3	-41
Title II -- Large partnership provision	3	183
Title III -- Foreign provisions	22	87
Title IV -- Other income tax provisions	-102	-255
Title V -- Estate & gift tax provisions	-*	-*
Title VI -- Excise tax provisions	-11	-31
Title VII -- Administrative provisions	+3	+15
Totals	-88	-42
H.R. 2775		
Title I -- Individual with §101	-37	-2,903
Individual without §101	-3	-17
Title II -- Tax-exempt bond provisions	-11	-111
Title III -- Administrative provisions	-23	+464
Title IV -- Estate & gift tax provision	+*	+40
Total with §101	-71	-2,510
Total without §101	-37	376

Department of the Treasury
Office of Tax Analysis

July 22, 1991

TREASURY NEWS

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

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FOR IMMEDIATE RELEASE

Contact: Cheryl Crispen
202-566-2041

STATEMENT BY
THE HONORABLE JOHN ROBSON
DEPUTY SECRETARY OF THE TREASURY
ON THE SIGNING OF A
MEMORANDUM OF UNDERSTANDING WITH THE
BULGARIAN NATIONAL BANK
JULY 23, 1991
WASHINGTON, D.C.

It is a pleasure to join my friends from the Ministry of Finance and the Bulgarian National Bank in signing this Memorandum of Understanding to establish an Institute of Banking for their reforming nation. This joint initiative for the education and training of future employees of banks and other financial institutions will be a crucial step to improve the banking system that is vital to Bulgaria's economic reform efforts and, indeed, to the very functioning of the country's economy.

This agreement is consistent with considerable ongoing international efforts to help all reforming nations. At the Economic Summit in London last week, the United States joined the other major industrial nations in renewing our firm commitment to supporting reforms in Central and Eastern Europe. For the United States, this means a commitment to help the region establish more efficient and effective financial systems for sustained economic growth.

In today's tough global marketplace, private business cannot exist without a modern, dependable and efficient banking system. Banks function as the allocators of credit for businesses -- large and small -- and as the fundamental facilitators of commerce through the payment system. Banks also create incentives for savings among individuals, families, entrepreneurs and large corporations. In turn, those savings provide capital that fuels the economy and helps businesses take advantage of new opportunities for growth in competitive markets.

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Yet, we have found that, for many countries trying to shift from a planned economy to a free market, one of the most ignored links in the reform chain is the banking system. Under the old regimes in these countries, including Bulgaria, banks had become instruments of central planning, serving the narrow interests of the regime in power rather than the broad interests of the population. It is clear that these countries now need full-service banking systems that help consumers purchase washing machines and cars, that safeguard the savings of couples who want to buy a house, that help businesses export to the United States or raise capital to expand their capacity.

In response to this need, the Bush Administration is providing expertise and technical assistance that can help new banks get on their feet. Already, we have agreements with Czechoslovakia and Yugoslavia to help put banking systems in place.

Today, the United States and Bulgaria are entering into a pledge to work together in establishing a better banking system for Bulgaria. Since a banking system is only as effective as the people who operate it, our agreement focuses on developing the human resources necessary to integrate Bulgaria's banks and capital markets into the broader international economy.

Specifically, the United States Treasury Department intends to work with existing and future commercial banks, along with the Bulgarian National Bank, to provide comprehensive training in banking and finance. We plan to help Bulgaria establish an Institute of Banking with a practical curriculum geared toward both entry-level technicians and mid-level managers. And, we are planning for programs to train Bulgarian instructors, enabling the Institute to become self-sustaining as soon as possible.

But while the United States is helping the Bulgarian people in the rebirth of the their commercial banking industry, the real work will be done by the Institute itself. With critically needed help from the Bulgarian commercial bankers and the Bulgarian National Bank, I hope we can work together to have the Institute up and running in the next few months.

I am confident the spirit of cooperation will continue to ensure the success of this agreement. The establishment of this Institute of Banking will be a strong move in the continued development of a sound banking system for Bulgaria. It will be a solid foundation for economic stability, sustained growth, and the fruits of free enterprise and market economics. Thank you.

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TREASURY NEWS

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DEPT. OF THE TREASURY

FOR RELEASE AT 2:30 P.M.
July 23, 1991

CONTACT: Office of Financing
202/376-4350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $ 20,800 million, to be issued August 1, 1991. This offering will provide about $2,725 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $ 18,085 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Monday, July 29, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Daylight Saving time, for competitive tenders. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 10,400 million, representing an additional amount of bills dated May 2, 1991 and to mature October 31, 1991 (CUSIP No. 912794 XL 3), currently outstanding in the amount of $ 8,023 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 10,400 million, to be dated August 1, 1991 and to mature January 30, 1992 (CUSIP No. 912794 XX 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 August 1, 1991. In addition to the maturing 13-week and 26-week bills, there are $ 10,691 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 $ 1,631 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $1,781 million as agents for foreign and international monetary authorities, and $ 7,297 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-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 one-half hour prior to the closing time for receipt of tenders 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 competitive 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.

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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

8/89

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

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FOR IMMEDIATE RELEASE
July 23, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 2-YEAR NOTES

Tenders for $12,549 million of 2-year notes, Series AD-1993, to be issued July 31, 1991 and to mature July 31, 1993 were accepted today (CUSIP: 912827B68).

The interest rate on the notes will be 6 7/8%. The range of accepted bids and corresponding prices are as follows:

	Yield	Price
Low	6.93%	99.899
High	6.95%	99.862
Average	6.94%	99.881

Tenders at the high yield were allotted 8%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	56,890	56,890
New York	33,466,005	11,121,645
Philadelphia	38,100	38,100
Cleveland	41,465	41,455
Richmond	128,405	53,405
Atlanta	51,965	42,350
Chicago	1,780,665	729,670
St. Louis	62,855	51,175
Minneapolis	26,315	25,315
Kansas City	70,255	70,255
Dallas	16,780	16,765
San Francisco	636,365	102,265
Treasury	199,465	199,465
TOTALS	$36,575,530	$12,548,755

The $12,549 million of accepted tenders includes $972 million of noncompetitive tenders and $11,577 million of competitive tenders from the public.

In addition, $478 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $587 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

NB-1383

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For Immediate Release
July 23, 1991

Claire E. Buchan
Appointed Deputy Assistant Secretary
For Public Affairs

Secretary of the Treasury Nicholas F. Brady today announced the appointment of Claire E. Buchan to serve as Deputy Assistant Secretary for Public Affairs. Ms. Buchan will serve as the principal advisor to the Assistant Secretary for Public Affairs and Public Liaison on communicating Treasury policies and programs to the public through the print and electronic media.

Prior to joining Treasury, Ms. Buchan was the Deputy Director of Communications for the Republican National Committee. Prior to her serving there, she was Press Secretary and Director of Public Affairs for the United States Trade Representative. Ms. Buchan has also served as Deputy Director of Public Affairs for the U.S. Department of Commerce and Press Secretary for Congressman H. James Saxton.

Ms. Buchan graduated from Michigan State University with a bachelor of arts degree in Business Administration. She resides in Alexandria, Virginia.

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TREASURY NEWS

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

IMMEDIATE RELEASE
July 23, 1991

Contact: Desiree Tucker-Sorini
(202) 566-8191

Statement
Office of the Assistant Secretary
for Public Affairs/Public Liaison
On
Soviet Membership in the IMF/World Bank

The Soviet Union has for some time expressed an interest in joining the IMF and World Bank. We understand that they submitted a formal application for membership to the two institutions on Monday, July 22.

At the London Economic Summit, July 15-17, it was agreed that as a matter of urgency the Soviet Union should be granted a Special Association with the IMF and World Bank as opposed to commencing a lengthy negotiation for full membership. This decision was based on a consensus among the G-7 that Special Association would provide the most substantive and rapid approach to addressing the reform of the Soviet economy and its eventual integration into the world economy. The U.S. believes that full membership negotiation between the Soviet Union and the IMF/World Bank is not the most effective way for proceeding with Soviet economic reform.

We understand that both the IMF and The World Bank are prepared to proceed immediately in developing a Special Association for the Soviet Union which would enable immediate progress to be made in reforming the economy in the Soviet Union and in providing technical assistance.

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Contact: Cheryl Crispen
202-566-2041

The Honorable Nicholas Brady
Secretary of the Treasury
Treasury Annual Awards Ceremony
July 24, 1991
Washington, D.C.

Thank you, David (Nummy). Thank you, also, to the awardees, families and friends with us at this ceremony. I know all the families share in Treasury's pride for the top-flight employees recognized today. This group represents the hard work and creativity that makes our Department a success.

The Annual Awards Ceremony is a distinguished tradition at Treasury -- pioneered by Secretary Douglas Dillon in 1964. Secretary Dillon was an innovative manager who recognized the important contributions of government employees. And he created the first Annual Awards to honor those who "distinguished themselves by reason of their high-level performance."

That first ceremony was on Treasury's 175th Anniversary, and the awards focused on significant Departmental suggestions and accomplishments for the early 1960s. One awardee suggested the use of new "stitching machines" for BEP -- to assemble food coupon booklets -- saving $16,000 for the taxpayers. Another suggested a new welding technique for Coast Guard buoys -- that's when the Coast Guard was still under Treasury.

Since then, each Treasury Secretary has had a different focus -- recognizing new awards and bringing new values to the ceremony. In 1979, the Equal Employment Opportunity Award and the Outstanding Handicapped Employee Award were recognized. In 1985, the Cash Management Award was added. And there are many others, including: small business awards, external awards, honor awards and 50-years of service awards.

This year, we are honoring a group of men and women chosen to represent our most recent award winners. We also are honoring the more than 400 Treasury employees who contributed to the dramatic success of Operations Desert Shield and Desert Storm. These men and women have demonstrated the ability we've seen among all Treasury employees to rise to any challenge and to serve our country.

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Each honoree recognized today has contributed beyond the call of duty to the Treasury Department, and each deserves our thanks and praise for ensuring efficiency and effectiveness that benefits American taxpayers.

Some of today's awardees have made suggestions that save the taxpayers money. Some have overcome physical and societal barriers, while excelling in the workplace. Others are contributing extensively to the President's war on drugs. And all are making critical and outstanding contributions that make this a better department. For example:

-- A group in New York sold a record number of savings bonds, achieving 110 percent of their goal.

-- A suggestion was made to automate the printing of target sheets for ATF firing ranges, leading to a cost savings of $14,000 annually. That's no small amount. If every government employee saved us $14,000, our nation would be more than $42 billion richer.

-- And a 65-year veteran of the U.S. Customs Service is being recognized today. Ferdinand Gallozzi, now Special Assistant to the Regional Commissioner in New York, began as a messenger for Customs in 1926.

These accomplishments are only a few of the first-rate efforts recognized today. Individually, they are extraordinary. Together, these contributions are part of a larger effort to keep our nation strong.

The accomplishments of today's awardees remind me of a story about another outstanding accomplishment -- the great Notre Dame Cathedral in Paris. During the building of the Cathedral, there were three bricklayers working at the site. The first was asked what he was doing; he replied: "I'm building a wall." The second was asked what he was doing. He replied: "I, too, am building a wall." When the third was asked, he replied: "I am building a great cathedral."

In that spirit, today's honorees have helped more than their offices and their department. Each is helping to build a more dependable and effective government for the United States.

These accomplishments are tremendous, and I am proud to salute all of today's awardees. You have truly made great contributions to the government and to the American people. Thank you very much.

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TREASURY NEWS

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

FOR RELEASE ON DELIVERY
Expected at 10:00 A.M.
July 24, 1991

STATEMENT OF THE TREASURY DEPARTMENT
PRESENTED TO THE
SUBCOMMITTEE ON POLICY RESEARCH AND INSURANCE
OF THE
HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

The Treasury Department welcomes this opportunity to discuss the results of the Treasury's second study of Government-sponsored enterprises and the Administration's legislation that will provide for more effective financial oversight of these important institutions.

The failure of many federally insured thrift institutions in the 1980s, and the massive Federal funding required for their resolution, have focused the attention of the Administration and Congress on other areas of taxpayer exposure to financial risk. With this concern in mind, Congress enacted legislation requiring the Secretary of the Treasury to study and make recommendations regarding the financial safety and soundness of GSEs.

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) requires the Treasury to conduct two annual studies to assess the financial safety and soundness of the activities of all Government-sponsored enterprises. The first of these studies was submitted to Congress in May 1990.

The Omnibus Budget Reconciliation Act of 1990 (OBRA) requires the Treasury to provide an objective assessment of the financial soundness of GSEs, the adequacy of the existing regulatory structure for GSEs, and the financial exposure of the Federal Government posed by GSEs. In addition, OBRA requires the Treasury to submit to Congress recommended legislation to ensure the financial soundness of GSEs. Legislation reflecting the approach identified in the April 30th report has been submitted.

The 1991 study is intended to meet the study requirements of FIRREA and OBRA. It includes an objective assessment of the financial soundness of the GSEs, which was performed by the Standard & Poor's Corporation (S&P) at the Treasury's request. The study also includes the results of the Treasury's analysis of the existing regulatory structure for GSEs and recommendations for changes to this structure.

The immense size and concentration of GSE activities serve to underscore the need for effective financial safety and soundness regulation of GSEs. The outstanding obligations of the GSEs, including direct debt and mortgage-backed securities, totaled almost $1 trillion at the end of calendar year 1990. Thus, financial insolvency of even one of the major GSEs would strain the U.S. and international financial systems and could result in a taxpayer-funded rescue operation.

The concentration of potential taxpayer exposure with GSEs is obvious when compared to the thrift and banking industries. The total of credit market debt plus mortgage pools of the five GSEs included in this report is greater than the total deposits of the more than 2,000 insured S&Ls and about one-third the size of the deposits of the more than 12,000 insured commercial banks. Consequently, the Federal Government's potential risk exposure from GSEs, rather than being dispersed across many thousands of institutions, is dependent on the managerial abilities of the officers of a relatively small group of entities.

Despite the size and importance of their activities, GSEs are insulated from the private market discipline applicable to other privately owned firms. The public policy missions of the GSEs, their ties to the Federal Government, the importance of their activities to the U.S. economy, their growing size, and the rescue of the Farm Credit System in the 1980s have led credit market participants to view these GSEs more as governmental than as private entities. Because of this perception, investors ignore the usual credit fundamentals of the GSEs and look to the Federal Government as the ultimate guarantor of GSE obligations.

Based on the S&P analysis of the financial safety and soundness of the GSEs, we have concluded, as we did last year, that no GSE poses an imminent financial threat. Because there is no immediate problem, there may be the temptation to follow the old adage "if it's not broke, don't fix it". We, however, believe that this course of action would be inappropriate. The experience with the troubled thrift industry and the Farm Credit System in the 1980s vividly demonstrates that taking action once a financial disaster has already taken place is costly and difficult.

Given the need for effective financial oversight of the GSEs, the Treasury has developed four principles of effective safety and soundness regulation. These principles are:

I. Financial safety and soundness regulation of GSEs must be given primacy over other public policy goals.

Regulation of GSEs involves multiple public policy goals. Without a clear statutory preference, a current GSE regulator need not give primary consideration to safety and soundness oversight. Therefore, unless a regulator has an explicit primary statutory mission to ensure safety and soundness, the Government may be exposed to excessive risk.

II. The regulator must have sufficient stature to avoid capture by the GSEs or special interests.

The problem of avoiding capture appears to be particularly acute in the case of regulation of GSEs. The principal GSEs are few in number; they have highly qualified staffs; they have strong support for their programs from special interest groups; and they have significant resources with which to influence political outcomes. A weak financial regulator would find GSE political power overwhelming and even the most powerful and respected Government agencies would find regulating such entities a challenge. Clearly, it is vital that any GSE financial regulator be given the necessary support, both political and material, to function effectively.

The Treasury Department is under no illusions concerning the capture problem. No regulatory structure can ensure that it will not happen. Continued recognition of the importance of ensuring prudent management of the GSEs and vigilance in this regard by both the executive and legislative branches will be necessary.

III. Private market risk mechanisms can be used to help the regulator assess the financial safety and soundness of GSEs.

The traditional structure and elements of financial oversight are an important starting point for GSE regulation. However, Governmental financial regulation over the last decade has failed to avert financial difficulties in the banking and thrift industries. Additionally, the financial services industry has become increasingly sophisticated in the creation of new financial products, and the pace of both change and product innovation has accelerated in the last several years. As a result, to avoid the prospect that GSEs might operate beyond the abilities of a financial regulator and to protect against the inherent shortcomings in applying a traditional financial services regulatory model to entities as unique as GSEs, it would be appropriate for the regulator to enlist the aid of the private sector in assessing the creditworthiness of these firms.

IV. The basic statutory authorities for safety and soundness regulation must be consistent across all GSEs. Oversight can be tailored through regulations that recognize the unique nature of each GSE.

The basic, but essential, authorities that a GSE regulator should have include:

(1) authority to determine capital standards;

(2) authority to require periodic disclosure of relevant financial information;

(3) authority to prescribe, if necessary, adequate standards for books and records and other internal controls;

(4) authority to conduct examinations; and

(5) authority to take prompt corrective action and administrative enforcement, including cease and desist powers, for a financially troubled GSE.

Consistency of financial oversight over GSEs does not imply that the regulatory burden is the same irrespective of the GSEs' relative risk to the taxpayer. Weaker GSEs should be subjected to much closer scrutiny than financially sound GSEs. However, the basic powers of the regulator to assure financial safety and soundness should be essentially the same for all GSEs.

Regulatory discretion is necessary within these broad powers because the GSEs are unique entities and, as such, need regulatory oversight that reflects the nature of the risks inherent in the way each conducts its business. Additionally, because financial products and markets change rapidly, regulatory discretion would allow for flexibility to deal with the changing financial environment.

The Treasury has analyzed the adequacy of the existing regulatory structure of the GSEs against the backdrop of the four principles of effective financial safety and soundness regulation. We have found deficiencies in the existing regulatory structure for some GSEs. The Farm Credit Administration does not have the full complement of regulatory authorities to be an effective safety and soundness regulator for Farmer Mac. The Administration's bill would give the FCA these additional authorities, which include general rulemaking authority, and supervision of the safe and sound performance of the Corporation utilizing authorities granted to FCA in existing law. This would clarify the FCA's authorities to set capital standards, for example, which we believe is fundamental for every safety and soundness regulator.

We are aware that the General Accounting Office has suggested the option of combining oversight of all the GSEs under a single regulator. There are certainly sound arguments in favor of such an approach, and creating one regulator for all of the GSEs could, if structured correctly, result in effective oversight of these entities. However, the advantage of the Administration's proposal is that Congress does not have to create yet another new bureaucracy. The Administration's bill utilizes the specialized expertise of the existing regulatory structure and makes it more effective, which would more than offset any savings or efficiencies from a single regulator.

In conclusion, we believe that the passage of the Administration's proposed legislation will result in more effective safety and soundness oversight of these important entities, thereby sharply reducing the threat the taxpayer would be called upon for another costly and painful financial rescue. Moreover, effective safety and soundness oversight, by assuring the long-term financial viability of the GSEs, will enhance the effectiveness of these entities in achieving their public purposes. Action on this legislation will send a strong signal that we have learned some important lessons from the recent and painful difficulties we have experienced in the financial services industry.

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AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

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FOR IMMEDIATE RELEASE
July 24, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 5-YEAR NOTES

Tenders for $9,331 million of 5-year notes, Series R-1996, to be issued July 31, 1991 and to mature July 31, 1996 were accepted today (CUSIP: 912827B76).

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

	Yield	Price
Low	7.88%	99.980
High	7.89%	99.939
Average	7.89%	99.939

$10,000 was accepted at lower yields.
Tenders at the high yield were allotted 45%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	41,072	41,047
New York	32,597,315	8,554,065
Philadelphia	23,951	23,791
Cleveland	42,551	42,551
Richmond	267,459	115,659
Atlanta	47,950	38,130
Chicago	1,486,209	226,784
St. Louis	37,592	36,842
Minneapolis	23,715	23,710
Kansas City	59,989	59,989
Dallas	17,469	17,417
San Francisco	388,583	104,232
Treasury	46,289	46,289
TOTALS	$35,080,144	$9,330,506

The $9,331 million of accepted tenders includes $922 million of noncompetitive tenders and $8,409 million of competitive tenders from the public.

In addition, $250 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $200 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

NB-1388

TREASURY NEWS

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AS PREPARED FOR DELIVERY
EMBARGOED UNTIL 3:00 p.m.
July 24, 1991

Contact: Barbara Clay
202-566-5252

The Honorable John E. Robson
Deputy Secretary of the Treasury
at the
Management Training and Market Economics
Education Ceremony
July 24, 1991
Washington, D.C.

It is a great pleasure to be here today to celebrate the kick-off of the Management Training and Market Economics Education program for Central and East Europeans. Management training and economics education are important planks in our Central and East European assistance effort. As President Bush stated at the February Conference at the White House which focused on this initiative, "educated, well-trained labor forces [are] absolutely crucial for economies in transition. [A] well informed populace lends support for reform."

In a few minutes, Dr. Ronald Roskens of AID and Ambassador Henry Catto of USIA will announce 20 projects, involving 32 U.S. colleges and universities, which will receive grants totalling $18 million. These projects will bring America's outstanding academic resources in management training, business education and economics education to thousands of people in Bulgaria, Czechoslovakia, Hungary, Poland, Romania, and Yugoslavia. Those involved in these projects are to be congratulated. They will make concrete contributions -- Washington State University's small business development center expertise will go to Romania; the "Big 10's" executive education know-how will be available in Poland, Czechoslovakia and Hungary; and video programs such as "Economics USA" will be shown throughout the region -- to name a few.

These projects represent a joint effort between the United States' public and private sectors to fulfill our commitment to assist the emergence of democracy and free market economies in Central and Eastern Europe. These projects will also have the important participation of Central and East European institutions. In fact, I hope to be able to meet with representatives of the two Romanian institutions who will be project participants when I visit Romania and Albania next week.

NB 1389

In addition to the specific grants to be announced today, other universities, corporations and non-profit organizations throughout the United States are organizing and funding their own programs to educate Central and East Europeans:

-- corporations are sending managers to U.S. executive education programs and hopefully will offer more slots in their management training programs;

-- non-profit organizations are teaming-up with universities and corporations to bring students to study in the U.S.;

-- business schools are sending MBA graduates to assist enterprises in the region; and

-- the Citizens Democracy Corps is matching United States participants and Central and East Europeans in this educational collaboration.

Dr. John Ryan, senior counsel to Dr. Ronald Roskens at AID, is available to work with these groups and to help sustain the momentum in this area.

We encourage and applaud these efforts. By knitting together the United States Government, universities, corporations and non-profit organizations, along with Central and East European institutions, we can accomplish our goal of exposing as many Central and East Europeans as possible to management training and market economics education.

Education is a necessary springboard for reform. But, a thriving business climate, where one must meet a payroll or compete with another manufacturer, will teach the principles of management training and free market economics faster than any course. Therefore, we must remember that management training and economics education is only <u>one</u> important tile in the mosaic of evolution to a free market economy.

We have learned that becoming a free market is a complex, multi-faceted process where many actions must be synchronized -- currency convertability, price liberalization, tax reform, financial sector development, private property rights, removal of trade barriers, privatization of state enterprises, and the establishment of "safety nets" to help cope with unemployment.

President Bush has repeatedly stated his determination to support Central and Eastern Europe's transformation to a free market economy. And, at the Economic Summit in London last week, the United States joined the other major industrial nations in renewing this commitment.

Since the historic decisions in Central and Eastern Europe to follow the course of democracy, the United States has provided almost $2 billion in grants and other assistance to the region. This includes technical assistance in excess of $200 million for privatization, management training, legal and financial reforms, strengthening democratic institutions, and bank training institutes such as the initiative announced just yesterday for Bulgaria.

We have established Enterprise Funds in Poland, Hungary and Czechoslovakia and capitalized them with $360 million to help breathe life into the private sector. We have supported the efforts of international financial institutions such as the International Monetary Fund, the World Bank and the newly created European Bank for Reconstruction and Development. And, on July 12, President Bush announced his Trade Enhancement Initiative for Central and Eastern Europe to expand access to export markets.

These efforts reflect our belief that the success of the economic transformation in Central and Eastern Europe cannot depend solely on the response of governments, and must look to the response of the private sector and the attraction of investment. And, in the end, although outsiders can help, successful transitions to free markets will be accomplished primarily through the skills and the fortitude of the people who have chosen the path toward market economies.

Free markets work best when they enjoy the confidence and understanding of the people who stand to benefit. By offering management training and market economics education to the people of Central and Eastern Europe, we can help accelerate the pace of reform, and we can foster the best training and education program available -- real business experience.

Thank you.

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TREASURY NEWS

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<u>For Release Upon Delivery</u>
Expected at 10:00 a.m.
July 25, 1991

STATEMENT OF
KENNETH W. GIDEON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON SELECT REVENUE MEASURES
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to present the views of the Department of the Treasury on several legislative proposals which deal with pensions. Specifically, my testimony will address the Administration's proposal for pension simplification and expanded coverage and portability as well as H.R. 2730, the "Pension Access and Simplification Act of 1991" (introduced June 24 by Chairman Rostenkowski), H.R. 2641 (introduced June 13 by Reps. Chandler, Archer, Matsui, Johnson, Guarini and Anthony) and H.R. 2742 (introduced June 25 by Rep. Cardin).

The Internal Revenue Code provisions relating to employee benefits have become increasingly complex in recent years. This complexity reflects both the wide variety of plans and their increasing sophistication. While the tax laws relating to employee benefits may never be "simple," they clearly can be simpler than they are now, particularly for small employers who neither need nor want more complex structures. Eliminating unneeded complexity will benefit both the taxpayer and the tax administrator and will offer the prospect of improved compliance.

Pension coverage and related pension portability issues have been a public policy concern for over two decades. Policies to expand pension coverage, particularly in the small business sector, and to enhance pension portability are necessary to strengthen the role of private pension plans in retirement income planning. To the extent that retirement income from private pensions is inadequate, there will be increasing pressure on Social Security and other government-sponsored systems.

In response to Chairman Rostenkowski's request last year for the Treasury Department's recommendations concerning simplification, we identified the employee benefit plan area as one that merited further study to determine whether viable simplification proposals could be developed. Since then, the Administration has worked on developing, through the joint efforts of the Treasury Department and the Department of Labor, proposals to simplify the tax law governing retirement plans, to expand pension coverage, and to increase pension portability. These proposals were announced on April 30, 1991, by Secretary of Labor Martin.

The Administration's proposals were crafted to accomplish these objectives within the constraint of revenue neutrality and, in total, do not lose revenue. As the Office of Tax Analysis estimates of the Administration proposals demonstrate (Table I), that requirement was satisfied. We understand that the Joint Committee on Taxation's estimates of the similar proposals in H.R. 2730 differ somewhat from our estimates, but not to a degree which has prevented formulation of a proposal satisfying the constraints of the Budget agreement.

ADMINISTRATION PROPOSALS

The Administration's proposals include a number of amendments to the Internal Revenue Code which would contribute substantially to the goals of simplifying the pension tax law, expanding pension coverage and enhancing pension portability. These proposals are as follows:

1. <u>Simplify and encourage tax-free rollovers</u>. We propose to simplify and encourage tax-free "rollovers" of pension distributions into IRAs or qualified plans by allowing all plan distributions to be rolled over, except distributions which are made in the form of a life annuity or in installment payments over 10 years or more. The current law restrictions on rollovers of after-tax employee contributions and minimum required distributions would be retained. Plans would be required to offer employees an election to have distributions eligible for rollover treatment transferred directly to an IRA or other qualified plan that accepts such contributions. The favorable income tax treatment for pension distributions which are not rolled over -- the special averaging rules and the deferral of tax on the appreciation on employer securities -- would be repealed and the method for determining the taxable amount of pension annuities would be simplified. The six rules potentially applicable to a pension distribution would be simplified to a single rule providing that such

distributions are currently taxed unless they are rolled over.

2. <u>Establish a new simplified employee pension program</u>. Employers with 100 or fewer employees and no other retirement plan would be eligible for the new plan. Under the proposal, these employers would be relieved from testing for nondiscrimination if they make a base contribution for each eligible employee of 2 percent of pay (up to a maximum base contribution of $2,000). Employees could elect to contribute $4,238 (one-half the limit on elective deferrals under 401(k) plans). In addition, the employer could make matching contributions of up to 50 percent of the employees' contributions.

3. <u>Simplify the administration of 401(k) and other plans</u>. The proposal would simplify the rules for testing whether 401(k) plans provide proportionate benefits to lower paid employees by using the prior year's experience. As a related matter, the proposal would also simplify the definition of "highly compensated employee" for purposes of the employee benefit provisions of the Code and repeal the complex family aggregation rules. In addition, the proposal would enhance the Internal Revenue Service master and prototype program under which affordable standardized plans can be offered.

4. <u>Make 401(k) plans generally available</u>. Section 401(k) plans would be extended to employees of tax-exempt organizations and State and local governments.

5. <u>Adopt a uniform vesting standard</u>. The vesting requirements for multiemployer plans would be conformed to the existing requirements for single employer plans.

We are pleased to see that most of the areas targeted by the Administration's proposals are included in each of the bills which is the subject of today's hearing.

ADMINISTRATION POSITION ON THE BILLS

H.R. 2730 is consistent with the Administration proposals, and we support its enactment. It adheres to national budget policy and demonstrates that simplification of the employee benefit provisions of the Internal Revenue Code can be achieved while access to qualified plans is expanded. The simplification provisions of the bill do not alter fundamental retirement and tax policies, but meaningful simplification is achieved. The bill simplifies and builds on existing structures and thus minimizes the complications inherent in any revision. We commend Chairman Rostenkowski for introducing the bill, and we have appreciated the opportunity to work with the Congressional staffs to turn proposals into proposed legislation.

In the current budgetary environment, any simplification proposals are constrained by the realities of the Federal budget. We understand from the Chairman's remarks on introduction of H.R. 2730, that he intends that the bill be revenue neutral. Our own revenue estimates, in connection with the Administration's pension proposals, demonstrate that this objective is attainable.

Our preliminary review indicates that both H.R. 2641 and H.R. 2742, in their current form, would lose significant revenue. The Administration must oppose pension legislation that loses revenue. In addition, as noted in more detail in our comments on specific provisions, we have substantive policy concerns about several provisions of H.R. 2641 and H.R. 2742.

A number of provisions in H.R. 2641 relate to recently proposed Treasury regulations. These regulations are primarily the nondiscrimination regulations originally proposed in May 1990 and the separate line of business regulations proposed in February 1991. In accordance with the Treasury's standard administrative practice, comments were requested with respect to the proposed regulations and public hearings were held. In the process for promulgating final regulations, we review all the written and oral comments received, consider them carefully and modify the regulations where appropriate in light of the public comment. We are nearing issuance of final regulations. Accordingly, we believe that Congressional action without reference to final regulations would be premature.

Of necessity, points of difference tend to be highlighted in testimony on multiple bills. However, in viewing the overall import of these three bills, I find more similarities than differences on fundamentals. We are ready to work with the Congress to move from this general consensus to enacted legislation.

Our substantive comments on the provisions of H.R. 2730, H.R. 2641 and H.R. 2742 follow.

Taxability of Distributions from Qualified Plans (Section 101, H.R. 2730; section 201, H.R. 2641; section 201, H.R. 2742)

Current Law

Distributions from qualified plans and other tax-preferred retirement programs are generally subject to income tax upon receipt. Premature distributions, generally those made before age 59½, may also be subject to a 10-percent additional tax. A number of special rules may alter the general rule if applicable.

Rollovers

Current income tax and, if applicable, the additional tax on a distribution can be avoided if the taxable portion of an eligible distribution is "rolled over" to another qualified plan or Individual Retirement Account (IRA). Only certain distributions (generally distributions that are either "qualified total distributions" or "partial distributions") are eligible for rollover treatment. As only the taxable portion of a distribution is eligible for rollover treatment, after-tax employee contributions may not be rolled over.

Lump Sum Distributions

Certain lump sum distributions are eligible to be taxed under special rules. These rules generally result in a lower rate of tax than would otherwise apply to a distribution. In general, a lump sum distribution is a distribution within one taxable year of the balance to the credit of the participant which becomes payable on account of death, separation from service, or disability, or after attainment of age 59½.

A participant or beneficiary generally may be able to elect to use the 5-year forward averaging rules with respect to a lump sum distribution if the distribution is received after age 59½. Five-year forward averaging is calculated under the tax rates in effect for the year of the distribution, and the election is available with respect to one distribution in an employee's lifetime. If a lump sum distribution is received before 1992, the recipient may also be able to elect to have the portion of the distribution attributable to pre-1974 plan participation taxed at capital gains rates.

Participants who attained age 50 before January 1, 1986, have three additional options which may reduce the rate of tax on a distribution. First, instead of using the 5-year forward averaging rules, they may continue to use the 10-year forward averaging rules available before the Tax Reform Act of 1986. Second, they may use the 5-year or 10-year forward averaging rules even if they are under the currently prescribed age requirement (age 59½) when they receive a distribution, if all of the other requirements for using those rules are met. Finally, they may elect to have the entire portion of a lump sum distribution attributable to pre-1974 participation taxed at a 20 percent rate.

If a lump sum distribution includes securities of the employer corporation, the net unrealized appreciation (NUA) in the employer securities is generally not subject to tax until the securities are sold, unless the recipient elects to have the normal distribution rules apply. When the securities are sold, the NUA is treated as long-term capital gain. If a distribution is not a lump sum distribution, only the NUA attributable to the employee's own contributions may be excluded from income under these special rules.

Death Benefit Exclusion

Up to $5,000 in death benefits paid by an employer upon the death of an employee may be excluded from gross income. If the death benefit is paid in the form of an annuity, the benefit is included in the recipient's "investment in the contract".

Proposal under H.R. 2730

The bill would eliminate all restrictions on the types of distributions eligible for rollover treatment, except for annuity payments and installment payments over 5 years or more. The present law restrictions on rollovers of after-tax employee contributions and minimum required distributions would also be retained.

The bill would also eliminate 5-year forward averaging for lump sum distributions and the current law treatment of NUA. The special averaging rules available to participants who attained age 50 before January 1, 1986 would also be repealed. Under a special transition rule, the current law rules would be available with respect to one-half of any otherwise eligible distribution made in taxable years beginning in 1992.

Finally, the $5,000 death benefit exclusion would be repealed.

Proposal under H.R. 2641 and H.R. 2742

Under H.R. 2641, the 5-year forward averaging rules would be repealed with respect to distributions received in taxable years beginning after 1996. The current law treatment of NUA and the special averaging rules available to participants who attained age 50 before January 1, 1986, however, would be retained. The bill would also permit any distributions to be rolled over, including after-tax employee contributions. Only minimum required distributions could not be rolled over.

The provisions of H.R. 2742 are generally the same as H.R. 2641 except that the repeal of 5-year forward averaging is effective in 1992, and after-tax contributions would not be eligible for rollover treatment.

Administration Position

We support the provisions of H.R. 2730 relating to pension distributions. H.R. 2730 includes all the key elements of the Administration's proposal relating to the taxation of distributions. It will provide a single simple rule for distributions -- that such distributions either can be rolled over and deferred or are currently taxable. While preserving and enhancing an easily accessible deferral mechanism (i.e., rollover IRAs), it will eliminate the need to evaluate multiple, complex alternatives on receipt of a distribution. Given the 1986 changes in the basic structure of the individual tax rates and brackets, the highly complex rules for forward averaging, NUA and capital gains treatment are no longer needed. The liberalized rollover proposal should also encourage employees to preserve their retirement savings. We also support repeal of the $5,000 death benefit exclusion.

Our revenue estimates have been premised on lump sum distributions of up to $750,000 being exempt from the 15 percent excise tax on excess distributions. We note that H.R. 2730 should be clarified to achieve this result.

H.R. 2641 and H.R. 2742 adopt certain of the provisions set forth above, but far fewer than would be required to fund the other changes set forth in those bills. Further, these bills do not significantly simplify pension distributions.

Simplified Method for Taxing Annuity Distributions under Certain Employer Plans (Section 102, H.R. 2730)

Current Law

Distributions from a qualified retirement plan are generally subject to income tax when paid, except to the extent that the distribution constitutes a return of the employee's own investment (primarily composed of after-tax contributions made by the employee). In addition, up to $5,000 in death benefits paid by an employer may be excluded from gross income. If the death benefit is paid in the form of an annuity, the benefit is included in the employee's investment amount. The portion of each annuity payment that is excludable from tax is equal to the employee's investment amount divided by the "expected return". The expected return is the total annual annuity payment multiplied by the distributee's remaining life expectancy at retirement. The Internal Revenue Service has issued tables of life expectancies that are used to calculate expected returns. In addition, the Internal Revenue Service has provided a simplified alternative method (Notice 88-118) under which the taxable portion of qualifying annuity payments is determined under a simplified exclusion ratio method.

Proposal

The general rule for calculating the taxable portion of a distribution would be replaced with a rule similar to the alternative method currently provided in Notice 88-118 issued by the Internal Revenue Service. The portion of each annuity payment that represents nontaxable return of the employee's investment amount generally is equal to the employee's total investment amount in the contract, divided by the number of anticipated payments determined under a specified table by reference to the age of the participant. If the recipient receives a lump sum payment in connection with the commencement of annuity payments, that payment is taxable under the rules relating to the taxation of annuities as if it were received before the annuity starting date.

Administration Position

We support the proposal. By adopting as a mandatory rule a procedure similar to Notice 88-118, the proposal will greatly simplify the calculation of the tax on a pension distribution involving a return of employee contributions without significant impact on the tax liability imposed.

Requirement that Qualified Plans Include Optional Trustee-to-Trustee Transfers of Eligible Rollover Distributions
(Section 103, H.R. 2730; section 202, H.R. 2742)

Current Law

Current law places various restrictions on pre-retirement distributions of benefits from qualified plans. When a permissible distribution is made from a plan, it generally is made directly to the participant or beneficiary and is subject to income tax and, in the case of a premature distribution, a 10 percent additional tax. Under certain circumstances, the recipient of a qualified plan distribution can avoid current income taxation and any 10 percent additional tax by rolling the distribution over into another qualified plan or IRA. When making a distribution that is eligible for rollover treatment, plan administrators are required to provide a written explanation of the rollover rules to the recipient. The circumstances under which such rollovers are permitted under current law are limited, however, and the rules applicable to them are very complex. In addition, rollovers must be made within 60 days of the distribution. The burden of this complexity falls primarily on the individual participants.

Proposal under H.R. 2730

Qualified plans would be required to give participants the option of having distributions that are eligible for rollover treatment transferred directly to an eligible transferee plan specified by the participant. An eligible transferee plan is an IRA, a qualified retirement plan, or a qualified annuity plan. Before making a distribution eligible for rollover treatment, the plan administrator would be required to provide a written notice to the participant of the direct transfer option and of the rollover rules.

Proposal under H.R. 2742

The bill would require qualified plans to make "applicable distributions" in the form of direct trustee-to-trustee transfers to an IRA or a qualified defined contribution plan that accepts such transfers as designated by the distributee. Applicable distributions would generally include any distributions permitted to be made by a plan over $500 that would have been subject to the 10 percent additional tax on early distributions if they have been distributed directly to the participant or beneficiary. Thus, exceptions to the required transfer provisions would be provided for certain distributions, including any distribution after the employee attains age 55 and distributions of employee contributions. The plan would be required to provide a method for designating the transferee plan where the distributee does not make a designation or where the transfer to the designated plan is not practical. The plan trustee would be required to provide a written notice to the participant of the transfer requirements and of the amount of the transfer. Similar rules would apply in the case of annuity plans and tax-sheltered annuities.

Administration Position

We support the proposal set forth in H.R. 2730. We believe that it would accomplish the objectives of the similar provision in H.R. 2742 without imposing a mandatory transfer not always desired by the plan participant. The proposal would facilitate the rollover of pension benefits and the preservation of such benefits for retirement purposes without imposing any significant additional burdens on employers.

We understand that under H.R. 2730 participants could direct the transfer to the qualified plan of a subsequent employer only if that qualified plan accepted rollover contributions. Acceptance of rollovers by defined benefit plans could be particularly problematic. The Pension Benefit Guaranty

Corporation (PBGC) has advised us that the rollover requirement is not feasible for plans for which it is trustee.

Salary Reduction Arrangement of Simplified Employee Pensions (Section 201, H.R. 2730; section 306, H.R. 2641; section 307, H.R. 2742)

Current Law

Under current law, an employer may establish a simplified employee pension (SEP) that accepts elective salary reduction contributions. In order for a salary reduction SEP (SARSEP) to qualify, the employer generally may have no more than 25 nonexcludable employees, at least 50 percent of all nonexcludable employees must elect to make such contributions, and the deferral percentage of each eligible highly compensated employee must not exceed 125 percent of the average deferral percentage of all eligible nonhighly compensated employees (the "ADP" test). If an employer maintains a SEP or a SARSEP, the plan generally must be provided to all employees who are age 21 or older, who have performed service for the employer in at least 3 out of the last 5 years and who have received over $363 (indexed) in compensation.

Proposal under H.R. 2730

The proposal would replace the current law SARSEP with a new model plan. The new plan would be available to employers with up to 100 nonexcludable employees provided the employer does not currently maintain any other retirement plan. The employer would be required to make a contribution of 3 percent of pay (up to a maximum base contribution of $3,000) for each eligible employee. If the employer had maintained a qualified plan at any time during the 2 preceding years, the required contribution would be increased to 5 percent.

Under the new model plan, employee salary reduction contributions up to $5,000 (indexed) and employer matching contributions of $0.50 for each $1.00 of salary reduction contribution would be permitted. The 50-percent participation requirement and the ADP test of current law would no longer apply. Employers would be required to inform employees of the plan and their opportunity to make salary reduction contributions, and annual statements would be required to be provided to them.

Proposals under H.R. 2641 and H.R. 2742

The bills would permit employers with up to 100 nonexcludable employees to set up current law SARSEPs and would eliminate the 50-percent participation requirement. In addition, the proposal would exempt a SARSEP from the otherwise applicable ADP test by adopting one of the design-based safe harbors provided under the bill with respect to 401(k) plans. Finally, the proposal generally would require SEPs of all types to cover every employee with at least 1 year of service.

Administration Position

We generally support the proposal contained in H.R. 2730. Pension coverage for employees of small business is lagging behind other segments of American business. One frequently cited reason for the lack of coverage is the administrative cost associated with the adoption and maintenance of a qualified plan. The proposal would make a simple program with low administrative cost available to all businesses with 100 or fewer employees. Furthermore, the program would, at the same time, ensure broad-based coverage of rank and file employees. The availability of such a vehicle should encourage plan formation.

In the Administration's pension proposal, we recommended a similar vehicle for expanding pension coverage for employees of small business. We note that the proposal contained in H.R. 2730 is similar to the Administration's proposal except that our proposal would have set the base contribution at 2 percent of pay (up to a maximum base contribution of $2,000) and would have capped the salary reduction contributions for 1991 at $4,238 (one-half the cap placed on salary reduction contributions under qualified cash or deferred arrangements ("401(k) plans")). We continue to believe that these would be more appropriate limits. We object to the increase for required base contributions because we believe it would discourage small employers from adopting the new plan.

We oppose the proposal contained in H.R. 2641 and H.R. 2742 to eliminate the 50-percent participation test and to create an exemption from the ADP test applicable to SARSEPs without requiring any base contribution. The effect would be to eliminate any requirement that pension coverage be actually provided (as opposed to made available) to nonhighly compensated employees. Absent actual coverage of a broad base of employees, we believe that the substantial tax expenditure provided for pension arrangements cannot be justified. The minimum contribution concept embodied in H.R. 2730 and the Administration's proposal would free small businesses from the burdens of experience-based testing, while at the same time ensuring broad-based coverage of nonhighly compensated employees.

Governments and Tax-Exempt Organizations Eligible Under Section 401(k) (Section 202, H.R. 2730; section 311, H.R. 2742)

Current Law

The Tax Reform Act of 1986 precluded tax-exempt employers as well as State and local governmental employers from adopting 401(k) plans for their employees. Certain existing plans (i.e., plans adopted by State and local governmental employers before May 6, 1986 and plans adopted by tax-exempt employers before July 2, 1986) were grandfathered.

Proposal

Under H.R. 2730, tax-exempt employers and State and local governmental employers would be permitted to adopt 401(k) plans for their employees. Under H.R. 2742, tax-exempt employers, but not State and local governmental employers, would be permitted to adopt 401(k) plans for their employees.

Administration Position

We support the proposal. As we have previously informed the Committee, we see no policy basis for precluding tax-exempt employers from adopting 401(k) plans for their employees. We believe this is also true with respect to State and local government employers. There are, however, revenue costs associated with both proposals which have prevented enactment of these proposals in the past. We believe this is an appropriate way to encourage expanded pension coverage and to remove an exception to the general availability of 401(k) plans.

Duties of Sponsors of Certain Prototype Plans (Section 203, H.R. 2730)

Current Law

Pursuant to revenue procedures and other administrative guidelines, the Internal Revenue Service currently administers a master and prototype program under which trade and professional associations, banks, insurance companies, brokerage houses, and other financial institutions can obtain Internal Revenue Service approval of model retirement plans and make the pre-approved plans available for adoption by their customers, investors or association members. Under similar administrative programs, law firms and other organizations are able to get advance approval of model plans.

Proposal

Under the proposal, the Secretary of the Treasury would be authorized to define the duties of sponsors of master and prototype and other model plans, consistent with the objective of protecting adopting employers from a sponsor's failure to timely amend the plan and with the objective of insuring that adequate administrative services are provided with respect to the plan. Model plan sponsors that did not comply with the duties imposed by Treasury regulations could be precluded from continuing to sponsor model plans. In addition, the proposal would authorize regulations relaxing the "anti-cut back" rules (that generally prohibit plan amendments having the effect of eliminating certain subsidies or optional forms of benefit) when an employer replaces an individually designed plan with an Internal Revenue Service approved model plan.

Administration Position

We support the proposal. The master and prototype plans provide another means of reducing the administrative costs of maintaining retirement plans. This is particularly important for small- and medium-sized businesses.

Modification of Definition of Leased Employee (Section 301, H.R. 2730; section 301, H.R. 2641; section 301, H.R. 2742)

Current Law

Section 414(n) of the Code provides that, for purposes of certain retirement and welfare benefit provisions of the Code, a leased employee is treated as an employee of the recipient of the leased employee's services. In order to be treated as a leased employee, a person must not be a common-law employee of the recipient and, in addition, must meet three requirements. First, the person must provide services to the recipient pursuant to an agreement between the recipient and a third-party leasing organization. Second, the person must provide the services to the recipient on a substantially full-time basis for at least 1 year. And, third, the services must be of a type historically performed by common-law employees in the business field of the recipient. Proposed regulations under section 414(n) were issued in August 1987.

Proposal

The bills would eliminate the third requirement that the services be of a type historically performed by common-law employees in the business field of the recipient. In place of the "historically performed" standard, H.R. 2730 would substitute a new requirement that the services be performed under "any significant direction or control" of the recipient. The new standard under H.R. 2641 would be "primary control over the manner in which such services are performed" and the standard under H.R. 2742 would be "control". The proposals under H.R. 2641 and H.R. 2742 generally would be retroactive to 1983.

Administration Position

We do not oppose the objective of these proposals if effective prospectively. We prefer the legislative language in H.R. 2730 and note that the technical explanation which accompanied the Chairman's floor statement upon introduction of the bill accords with our understanding of the provision. We understand the intent is to limit section 414(n) to the abuses Congress originally sought to target when it enacted the section in 1983. As we have previously stated, we intend to withdraw those portions of the proposed regulations relating to the "historically performed" standard under section 414(n). We have deferred such action, however, pending Congressional revision of the standard to be applied in new regulations.

We believe that any new standard adopted by Congress should be clear in its application to specific cases. In this regard, we suggest that detailed examples in the legislative history be provided to demonstrate the intended application of the standard. "Control" in this context should not be determined by reference to employment tax concepts and should reflect the realities of the relationship, not merely its form.

Simplification of Nondiscrimination Tests Applicable Under Sections 401(k) and 401(m) (Section 302, H.R. 2730; section 104, H.R. 2641; section 105, H.R. 2742)

Current Law

Elective salary deferral contributions to a 401(k) plan are generally required to meet a special average deferral percentage (ADP) test. To satisfy the ADP test, the average of the deferral rates (expressed as a percentage of compensation) for each highly compensated employee eligible to participate in the plan generally may not exceed the greater of (1) 125 percent of the average of the deferral rates of all nonhighly compensated employees eligible to participate in the plan or (2) the lesser of (a) 200 percent of the average of the deferral rates of all nonhighly compensated employees eligible to participate in the plan, or (b) such average plus 2 percentage points. If a plan does not satisfy the ADP test for a year, excess deferrals by highly compensated employees must be either redistributed to them or recharacterized as after-tax contributions in order to retain the qualified status of the 401(k) plan. The distributions or recharacterizations are made on the basis of the respective portions of excess contributions attributable to each highly compensated employee.

If a plan permits after-tax employee contributions, or provides for employer contributions that are contingent on a participant's elective deferrals or after-tax employee contributions ("matching contributions"), the amount of such contributions generally must satisfy a special average contributions percentage (ACP) test. The ACP test is generally the same as the ADP test described above, except that it applies to matching and after-tax employee contributions rather than to elective deferrals. Rules analogous to the distribution rules under the ADP test must also be followed if the ACP test is not satisfied. Multiple use of the alternative limit (i.e., the 200 percent/2 percentage points test) cannot be used in satisfying both the ADP test and the ACP test.

Proposal under H.R. 2730

The ADP test would be modified such that each eligible highly compensated employee individually would not be permitted to defer more than 200 percent of the average of the deferral rates for the eligible nonhighly compensated employees for the preceding plan year. In the case of an employer that has not previously maintained a 401(k) plan, the ADP test for the first plan year would be calculated as if the nonhighly compensated employee deferral rate was 3 percent.

Corresponding modifications would be made to the ACP test. The proposal would also repeal the multiple use test, and would no longer permit recharacterization of excess deferrals as after-tax employee contributions.

Proposal under H.R. 2641 and 2742

The proposals would create certain safe harbors that would, in effect, deem either the ADP test or the ACP test, or both, to have been satisfied with respect to elective deferrals and matching contributions if the plan meets certain design and notice criteria. Under H.R. 2641, the ADP test would be deemed to have been satisfied if the plan provided (1) matching contributions with respect to all nonhighly compensated employees equal to 100 percent of elective deferrals up to 3 percent of compensation, (2) matching contributions with respect to such employees equal to 50 percent of elective deferrals up to 6 percent of compensation or (3) nonelective contributions equal to at least 3 percent of compensation to all nonhighly compensated employees eligible to participate in the plan. Any contributions used to satisfy the safe harbor would be required to be fully vested and subject to the 401(k) restrictions on withdrawals. In addition, such contributions could not make use of the permitted disparity rules (section 401(l)). The safe harbor would also require the employer to provide notice, within a reasonable period before the beginning of a year, to all employees eligible to participate of their rights and obligations under the plan. For employers who do not choose to use one of the design based safe harbors, the proposal would permit the ADP and ACP tests to be based on prior year's average deferral and contribution percentages for the nonhighly compensated employees.

The ACP test would be deemed to have been satisfied with respect to matching contributions if the design and notice criteria relating to the ADP test were met and, in addition, (1) matching contributions were not made with respect to employee contributions or elective deferrals in excess of 6 percent of an employee's compensation, (2) the level of matching contributions did not increase with the level of employee or matching contributions, and (3) the rate of matching contributions at each level of compensation was no higher for highly compensated than nonhighly compensated employees.

The proposal under H.R. 2742 is generally the same except that the ADP test would be deemed to have been satisfied if the plan either (1) provided matching contributions with respect to all nonhighly compensated employees equal to 100 percent of elective deferrals up to 3 percent of compensation and equal to 50 percent of elective deferrals between 3 and 5 percent of compensation or (2) provided nonelective contributions equal to at least 3 percent of compensation to all nonhighly compensated employees eligible to participate in the plan. In addition, certain alternative matching formulas would be allowed, subject to nondiscrimination requirements, but the alternative to use the prior plan year ADP is not included in the proposal.

Administration Position

We support the proposal contained in H.R. 2730. We believe the approach taken in the proposal would make the results of the ADP and ACP tests more predictable and would significantly reduce, if not eliminate, the likelihood of excess contributions. An employer would no longer need to monitor the average deferrals for the nonhighly compensated employees and the highly compensated employees during the current plan year in order to avoid the complicated correction mechanisms. Instead, the maximum contribution percentage for each highly compensated employee would be known at the beginning of the plan year. By minimizing the potential for excess contributions, the most significant source of complexity in 401(k) plans will be eliminated. H.R. 2641 also permits the prior year average deferral and contribution rates to be used in the ADP and ACP tests.

We oppose the provisions contained in H.R. 2641 and H.R. 2742 which contain alternatives to the ADP and ACP tests by allowing plans to satisfy nondiscrimination testing merely by making matching contributions available. These proposals represent a significant change in policy, not a simplification. We believe they would seriously erode current policies against discrimination in retirement plans because they provide no assurance that benefits will be provided to nonhighly compensated employees. As we have stated in the past, we believe that the principal sources of complexity in this area are not the basic ADP and ACP tests but rather the rules applicable to the distribution and recharacterization of excess deferrals and contributions. Thus, we believe that simplification of these rules -- not abandonment of the fundamental policy underlying these nondiscrimination rules -- should be the simplification objective in this area.

The present-law ADP and ACP tests provide a clear incentive for employers to design a plan that is attractive to rank-and-file employees and to make every effort to communicate the plan to those employees, since the actual level of participation by those employees directly affects the permitted level of deferrals by highly compensated employees. By contrast, while the proposals contained in H.R. 2641 and H.R. 2742 do require notice of the plan to be given to eligible employees buttressed by penalties for failure to do so, they provide no affirmative incentive to provide benefits in excess of the statutory minimum. In fact, such a test is a disincentive to do so since, once the design-based criteria have been met, any additional participation by the nonhighly compensated employees will generally increase the cost of a plan.

The Administration proposals and H.R. 2730 (section 201) will provide a design-based basic plan for small employers while continuing to make 401(k) plans generally available. Given the large growth in the popularity of such plans in recent years and the very real benefits provided to a broad base of employees, we believe that the better approach is to simplify the current 401(k) incentive structure -- not abandon it.

<u>Definition of Highly Compensated Employee</u> (Section 303, H.R. 2730; section 101, H.R. 2641; section 101, H.R. 2742)

<u>Current Law</u>

The Code defines the term "highly compensated employee" to include any employee who during the current or preceding year (1) was a 5-percent owner, (2) earned over $90,803 (indexed) in compensation, (3) earned over $60,535 (indexed) in compensation and was in the top 20 percent of the employer's workforce by compensation, or (4) was an officer earning compensation over $54,482 (indexed) or was the highest paid officer, if no officer earned more than the stated amount. Current law permits certain employers to treat, on an elective basis, all employees earning over $60,535 (indexed) as highly compensated employees regardless of whether they are in the top 20 percent of the employer's workforce by compensation. In addition, for purposes of identifying highly compensated employees, certain family aggregation rules apply in the case of 5-percent owners and other highly compensated employees who are among the top 10 employees by compensation. Different family aggregation rules may apply for purposes of the limitation on compensation that may be taken into account under a qualified plan (section 401(a)(17)). These latter rules limit the family members required to be aggregated to the employee's spouse and lineal descendants under age 19.

Proposal under H.R. 2730

The bill would modify the current law definition of the term highly compensated employee to include only 5-percent owners and employees who earn over $65,000 (indexed). If an employer had no highly compensated employees under this definition, then the one employee with the highest compensation would be treated as highly compensated. The family aggregation rules would be modified to conform to those applicable for purposes of determining the compensation limit applicable under qualified plans.

Proposal under H.R. 2641 and H.R. 2742

H.R. 2641 would redefine the term highly compensated employee to include only 5-percent owners and employees who earn over $60,535 (as indexed). If an employer had no highly compensated employees under this definition, then the one officer with the highest compensation would be treated as highly compensated, except for purposes of sections 401(k) and (m) (relating to elective deferrals, matching contributions and employee contributions). The family aggregation rules for purposes of the definition of highly compensated employee would be repealed.

The proposal under H.R. 2742 is generally the same as H.R. 2641, except that a one-employee rule would be substituted for the one-officer rule and tax-exempt employers (including State and local governments) would also be exempt from that rule. The family aggregation rules would be limited to 5-percent owners.

Administration Position

We support the proposal to simplify the definition of highly compensated employees. The elimination of the rules regarding officers and the top 20 percent of employees by compensation simplifies current law without sacrificing important policy objectives.

We oppose the exception to the one-employee rule contained in H.R. 2641 and H.R. 2742 which, under certain circumstances, would eliminate the requirement that at least one employee be treated as highly compensated because such a proposal effectively eliminates the nondiscrimination rules for certain employers.

Finally, we believe that the family aggregation rules are a source of great complexity and create inequities for two wage earner families where both spouses work for the same employer. Accordingly, we support the proposal in H.R. 2641 to repeal the family aggregation rules as set forth in the Administration proposal released in April.

Modifications of Cost-of-Living Adjustments (Section 304, H.R. 2730; section 102, H.R. 2641; section 102, H.R. 2742)

Current Law

Cost-of-living adjustments to various dollar limitations are currently made under adjustment procedures similar to those used for adjusting benefits under the Social Security Act. These cost-of-living increases under the Code are adjusted generally by using the last calendar quarter of a year and a base period of the last calendar quarter of 1986. Under this procedure, cost-of-living adjustments to the Code limitations are announced after the beginning of the year in which they are effective.

Proposal

The bills would require the cost-of-living adjustment to be based on increases in the applicable index as of the close of the calendar quarter ending September 30 of the preceding calendar year. The proposal would also require that dollar amounts, as adjusted, be rounded to the nearest $1,000 (or to the nearest $100 in the case of the limitations on elective deferrals and in the case of the minimum compensation amounts applicable to SEPs).

Administration Position

We support the proposal. It would permit the publication of applicable limits before the beginning of a calendar year for which they will be in effect and hence should assist plan administrators and plan participants. Similarly, the use of rounding would ease administration and employee communications.

Elimination of Half-Year Requirements (Section 305, H.R. 2730; section 302, H.R. 2742)

Current Law

A number of employee benefit provisions, such as those relating to permissible and required distributions from qualified retirement plans, are based on the attainment of age 59½ or age 70½.

Proposal

Under the bills, the half-year requirements would be eliminated so that each reference to age 59½ would become one to age 59 and each reference to age 70½ would become one to age 70.

Administration Position

We do not oppose this proposal, although we question whether requiring such a change in plans would in fact be simplifying.

Plans Covering Self-Employed Individuals (Section 306, H.R. 2730; section 302, H.R. 2641; section 303, H.R. 2742)

Current Law

Special employer aggregation rules apply to certain self-employed owner-employees participating in a tax-qualified retirement plan and controlling more than one business. The control group rules applicable to all employers under section 414(b) and (c) also apply to businesses controlled by self-employed owner-employees.

Proposal

The proposal would eliminate the special employer aggregation rules for self-employed owner-employees and would leave the generally applicable control group rules in place.

Administration Position

We do not oppose the proposal. The generally applicable control group rules should be sufficient to ensure against possible abuses with respect to plans maintained by self-employed owner-employees.

<u>Alternative Full-Funding Limitation</u> (Section 307, H.R. 2730; section 303, H.R. 2641; section 304, H.R. 2742)

<u>Current Law</u>

Under current law, an employer may generally make deductible contributions to a qualified defined benefit plan (including a multiemployer plan) subject to certain limitations, including the full funding limitation. The full funding limitation is generally the excess, if any, of the lesser of (1) 150-percent-of-current-liability or (2) the accrued liability (including normal cost) under the plan over the lesser of (i) the fair market value of the plan's assets or (ii) the value of the plan's assets determined under section 412(c)(2). Valuations of plan assets and liabilities are required at least annually.

The Secretary of the Treasury is granted regulatory authority to adjust the 150 percent figure to take into account the respective ages or lengths of service of the participants. In addition, the Secretary is granted regulatory authority to provide alternative methods based on factors other than current liability for the determination of the full funding limitation. The Secretary is to exercise this regulatory authority only in a revenue neutral manner. Because any such change would, by necessity, adversely affect some taxpayers and benefit other taxpayers, the Treasury Department has concluded that it will not exercise this authority unless directed by the Congress to do so.

<u>Proposal under H.R. 2730</u>

The bill permits certain employers to elect to apply the current law full funding limitation without regard to the 150-percent-of-current-liability limitation. The Secretary would be required under the provision to adjust the full funding limitation in a specified manner for all plans other than those making the election so that the provision is revenue neutral.

<u>Proposal under H.R. 2641 and H.R. 2742</u>

In the case of multiemployer plans, the bills would amend current law to return to the rules in effect prior to the changes made by the Pension Protection Act of 1987. Thus, the 150-percent-of-current-liability prong of the calculation of the numerator of the full funding definition would be eliminated and valuations of multiemployer plans would be required only every 3 years.

<u>Administration Position</u>

We do not oppose the proposal as set forth in H.R. 2730. Earlier this year we prepared a "Report to Congress on The Effect of the Full Funding Limit on Pension Benefit Security." In that report we noted that the full funding limit has an uneven impact among employers, and may have the greatest effect on plans that cover relatively young employees. In that report, we discussed a possible option to permit plans to make a one-time election to use an alternative funding limitation based on 100 percent of projected liability (as described in the report). We estimated that the 150 percent funding limit would need to be reduced to 147 percent in order to offset the revenue shortfall resulting from employer elections of the alternative full funding limitation. Unlike the proposed bill, the calculation incorporated no restriction on which employers were eligible to make the election, but did assume that the alternative full funding limitation used by electing employers could be calculated only under a specific actuarial method (the projected unit credit method) using interest rate and salary growth assumptions which are within designated ranges. We have not prepared an estimate, but believe that the adjustment to the 150 percent funding limit required by the proposal would be similar.

We are concerned that the proposal in H.R. 2730 in its current form may impose significant administrative burdens on employers, who would not be able to predict their plans' funding levels, as well as on the Treasury Department and the Internal Revenue Service. These burdens would include monitoring elections to use the alternative funding limitation every year, making a determination as to whether such elections result in more than an insubstantial net reduction in Federal revenues for any fiscal year, and promulgating annual adjustments to the current law full funding limitations that would remain applicable to non-electing plan sponsors to make up any revenue shortfall. In particular, the Committee should consider permitting adjustments on a less frequent basis than annual and permitting the adjustment to be based on the estimated effect of elections.

We oppose the proposal in H.R. 2641 and H.R. 2742. A complete waiver for multiemployer plans of the 150-percent-of-current-liability prong of the full funding limit involves substantial revenue loss. We do not believe that an exception to the generally applicable funding rules should be provided simply because the plan is a multiemployer plan.

Distributions Under Rural Cooperative Plans (Section 308, H.R. 2730; section 308, H.R. 2641; section 309, H.R. 2742)

Current Law

Distributions from 401(k) plans may be made upon attainment of age 59½, and distributions from profit-sharing plans may be made in certain events, including attainment of a stated age. Distribution from pension plans (including money purchase pension plans) generally must not commence until retirement.

Proposal

The proposal would permit distributions after attainment of age 59 from a money purchase rural cooperative plan which includes a 401(k) plan. Such distributions would not be limited to the 401(k) portion of the plan. The proposal in H.R. 2641 and H.R. 2742 is made retroactive, generally to 1987.

Administration Position

We oppose the proposal insofar as it creates a retroactive special exception for a limited group of tax-qualified plans. We do not oppose the proposal if effective prospectively as in H.R. 2730. However, we note that there would appear to be no impediment under current law for the rural cooperative plans to be converted to profit-sharing plans under which distributions upon the attainment of a stated age would be permissible.

Special Rules for Plans Covering Pilots (Section 309, H.R. 2730)

Current Law

For purposes of determining whether a qualified plan established pursuant to a collective bargaining agreement between airline pilots and one or more employer satisfies the minimum coverage rules, all employees not covered by the collective bargaining agreement are disregarded.

Proposal

The bill extends the current law rule to nonunion airline pilots employed by one or more common carrier engaged in interstate or foreign commerce or employed by carriers transporting mail for or under contract with the Federal Government.

Administration Position

We do not oppose the proposal.

Elimination of Special Vesting Rule for Multiemployer Plans (Section 310, H.R. 2730)

Current Law

Multiemployer plans are permitted to use a 10-year cliff vesting schedule. By contrast, the Tax Reform Act of 1986 subjected single-employer plans to shorter minimum vesting standards, i.e., 5-year cliff vesting or 7-year graded vesting.

Proposal

Multiemployer plans would be subject to the same minimum vesting standards as single-employer plans.

Administration Position

We support the proposal. It will expand pension coverage by providing employees covered under multiemployer plans with the same vesting rights as employees covered under single-employer plans.

Definition of Retirement Age (Section 311, H.R. 2730; section 312, H.R. 2641)

Current Law

A qualified plan is required to provide that benefits will commence no later than the 60th day after the latest of the close of the plan year in which one of several events occurs. One of these events is the attainment of age 65 or an earlier normal retirement age specified in the plan. In addition, the Code and ERISA require that, for vesting and accrual purposes, normal retirement age means the earlier of (1) the time a participant attains normal retirement age under the plan, or (2) the later of the time a participant attains age 65 or the 5th anniversary of the time the participant commenced participation in the plan. For purposes of the limits on contributions and benefits (section 415), however, the social security retirement age is generally used. Under section 415, the social security retirement age increases to age 66 for individuals born after 1938 and to age 67 for individuals born after 1954.

Proposal

The bills would amend the definitions of normal retirement age by replacing age 65 with the social security retirement age (as determined under section 415) for purposes of the benefit commencement rules and the vesting and accrual rules. In addition, H.R. 2641 would provide that the social security retirement age would be treated as a uniform retirement age for purposes of nondiscrimination testing.

Administration Position

We support the proposal. The proposal will facilitate the use by qualified plans of a uniform retirement age consistent with the retirement age under Social Security. We do not oppose the additional language set forth in H.R. 2641 for this provision.

Modification of Additional Participation Requirements (Section 103, H.R. 2641; section 104, H.R. 2742)

Current Law

Qualified plans, including both defined benefit and defined contribution plans, are generally required to benefit the lesser of 50 employees or 40 percent of the employer's workforce.

Proposal

The bills would exempt defined contribution plans from the minimum participation rules. The bills also modify the minimum participation rule by lowering the 50-employee threshold to 25 employees and by requiring an employer with 2 or more employees to cover at least 2 employees under the same plan. The bills would also permit employers to elect to have the new rules apply as if they had been included in the Tax Reform Act of 1986. Finally, H.R. 2641 would permit the minimum participation rules to be tested on one representative day during the plan year.

Administration Position

We do not support the proposal. We doubt that it will be simplifying because it would generally permit employers to maintain a greater number of qualified plans with a smaller number of participants in each plan and will impose additional administrative burdens on the Internal Revenue Service.

We oppose the portion of the proposal that permits employers to elect a retroactive effective date. We also note that the portion of the proposal that would permit representative day testing in certain cases is unnecessary as that simplified testing method is already permitted by regulation.

Required Distributions (Section 202, H.R. 2641; section 202, H.R. 2742)

Current Law

Under current law, distributions under most tax-preferred retirement arrangements must begin by no later than April 1st of the calendar year following the calendar year in which the participant attains age $70\frac{1}{2}$, regardless of when the participant retires.

Proposal

The bills would amend current law to return to the rule in effect prior to the changes made by the Tax Reform Act of 1986 and permit minimum required distributions to be delayed until retirement in the case of participants working after age 70½ provided an actuarial adjustment is made if no other benefits are accruing. Current law would continue to apply to 5 percent owners, and under H.R. 2641 to individuals with account balances of $750,000. Governmental plans and church plans would be exempt from the provisions retaining current law in specified instances and from the provision requiring actuarial adjustment.

Administration Position

We do not oppose allowing a delay in required distributions until actual retirement except with respect to 5 percent owners, provided that the actuarial adjustment required in the case of delayed distributions is fair and realistic. We favor retaining current law in the case of individuals with account balances in excess of $750,000. However, we oppose exempting governmental and church plans from the actuarial adjustment requirement. Employees covered under those plans should be entitled to the same protections as employees covered under other plans.

Treatment of Certain Distributions Under a Governmental Plan (Section 204, H.R. 2742)

Current Law

If a rollover is made of amounts not eligible for rollover treatment, the amount will generally be treated as an excess contribution subject to an excise tax.

Proposal

Under the proposal the Internal Revenue Service would be required to provide relief for certain distributions under a governmental plan received in 1990, if (1) distributions were made from such plan during 1987, 1988, 1989 and 1990 in connection with the transition to a new retirement system, (2) employees erroneously treated such distributions as eligible for rollover treatment and (3) the Internal Revenue Service is providing relief with respect to 1987, 1988 and 1989.

Administration Position

We do not support the proposal. We recognize, however, that the effect of the proposal is limited to 1990. We also note that if the expanded rollover provisions in the Administration's proposal and H.R. 2730 are adopted, these issues should be resolved with respect to future distributions.

Affiliation Requirements for Employers Jointly Maintaining a Voluntary Employees' Beneficiary Association (Section 304, H.R. 2641; section 305, H.R. 2742)

Current Law

Under Treasury regulations, a voluntary employees' beneficiary association (VEBA) is not tax-exempt under section 501(c)(9) of the Code if it benefits employees who do not share an employment-related common bond. An employment-related common bond generally exists only among employees of the same employer (or affiliated employers), employees covered by a collective bargaining agreement, members of a labor union, or employees of unaffiliated employers doing business in the same line of business in the same geographic locale. The Internal Revenue Service has interpreted the same geographic locale requirement as prohibiting a VEBA from covering nonunion employees of unaffiliated employers located in more than one state or metropolitan area. The same geographic locale requirement was held to be invalid by the 7th Circuit in Water Quality Ass'n Employees' Benefit Corp. v. United States, 795 F.2d 1303 (1986).

Proposal

The bills would exempt VEBAs maintained by unaffiliated employers from the same geographic locale requirement if they (1) are in the same line of business, (2) act jointly to perform tasks which are integral to the activities of each of the employers, and (3) act jointly to such an extent that the joint maintenance of a voluntary employees' beneficiary association is not a major part of the employers' joint activities.

Administration Position

We oppose the proposal in the bills; however, as discussed below, we would consider a more limited change to the VEBA rules. The same geographic locale requirement helps target the tax benefits available under section 501(c)(9) to organizations with the greatest need for support. The VEBA tax exemption was initially intended to benefit associations formed and managed by employees of a single employer or of small local groups of employers, to provide certain welfare benefits to their members in situations where such benefits would not otherwise have been available. Congress was concerned that such associations might not be viable without a tax exemption. By contrast, larger associations covering employees of unrelated employers in different geographic areas are more likely to be viable even without a tax exemption, and the benefits they provide are more likely to be able to be provided through commercial insurance.

The fact that unaffiliated employers would be required under the bills to conduct certain joint activities does not address these concerns. Moreover, we are concerned that the nature and required level of joint activities under the bills is so unclear that the exemption will apply to a large group of employers. This would have serious revenue consequences and, in addition, would undermine those provisions of the Code that prescribe the treatment of insurance companies.

Although we oppose the proposed exemption from the geographic locale requirement for the reasons stated above, we understand that the one-state or metropolitan area rule may be too restrictive in states or metropolitan areas with too few employees in the same industry to form an economical multiple-employer VEBA. An alternative to the proposal in the bills would be to limit VEBAs to a three-contiguous-state area, or a larger area if the Secretary determined that the employer group in the three-state area was too small to make self-insurance economical. If an acceptable offset were provided, we would not oppose such a modification.

<u>Treatment of Certain Governmental Plans</u> (Section 305, H.R. 2641; section 306, H.R. 2742)

<u>Current Law</u>

Benefits payable under qualified defined benefit plans generally are limited to the lesser of $90,000 (indexed) or 100 percent of compensation (section 415). A number of circumstances may give rise to required adjustments to these limitations, including situations where benefits commence before age 62, in the case of a governmental plan, or where there is less than 10 years of service or participation in the plan. Under a special transition rule, government plans are permitted to elect to have pre-1988 limits apply with respect to qualified participants.

The basic definition of compensation under current law used to determine the limits on contributions and benefits is defined to conform as closely as possible to total taxable income received from the employer. Thus, salary reduction amounts excluded from an employee's gross income are not taken into account in determining compensation for this purpose.

Excess benefit plans of governmental employers providing benefits for certain employees in excess of the section 415 limitations on benefits and contributions under qualified plans are subject to the provisions of section 457, which include an annual cap on benefits of $7,500 (or, if less, 33-1/3 percent of compensation).

Proposal

The bills would exempt benefits under governmental plans from the 100 percent of compensation limitation. The bills would also exempt certain survivor and disability benefits under governmental plans from the adjustment for pre-age 62 commencement, and from the participation and service adjustments generally required to be made to the section 415 limitations on benefits.

For purposes of determining the limits on contributions and benefits under a governmental plan, the bills would include certain salary reduction amounts in compensation. The bills would exempt governmental excess benefit plans from the provisions of section 457. Finally, the bills would permit a revocation of an election to have the pre-1988 limitations apply to qualified participants.

While the general effective date of the proposal is taxable years beginning after the date of enactment, the bills provide that plans are treated as satisfying the requirements of section 415 for all taxable years beginning before the date of enactment.

Administration Position

We oppose the proposal creating an exception to the 100 percent of compensation limitation. The proposal would violate the long-standing policy against permitting benefits payable under qualified defined benefit plans to exceed 100 percent of compensation and does not present an appropriate case for making an exception to that policy.

We oppose the proposal creating a broad exception for survivor and disability benefits under governmental plans. We note, however, that certain pre-retirement survivor and disability benefits under governmental plans are not generally subject to the limitations on contributions and benefits under current Internal Revenue Service interpretation.

We oppose the proposal to include salary reduction amounts in compensation for purposes of determining the limits on contributions and benefits under governmental plans. The proposal is inconsistent with the general policy that amounts excluded from gross income should not be taken into account for this purpose.

We oppose the excess benefit plan proposal. The scope of the proposal is narrowly drafted to cover only excess benefit plans maintained by one limited group of those employers subject to section 457.

We oppose the provision deeming all governmental plans to have satisfied the limits on contributions and benefits for all prior years. The proposal is in effect a retroactive repeal of those limits.

Contributions on Behalf of Disabled Employees (Section 307, H.R. 2641; section 308, H.R. 2742)

Current Law

An employer may make certain nonforfeitable contributions to a tax-qualified defined contribution plan on behalf of any disabled participant who is not highly compensated if an election is made.

Proposal

The bills would permit nonforfeitable contributions to be made on behalf of highly compensated disabled participants for a fixed or determinable period and would waive the election requirement, if contributions were made on behalf of all disabled participants.

Administration Position

We would not oppose the proposal if it were modified to insure that the provision does not operate in a manner that discriminates in favor of highly compensated employees and if an acceptable offset is provided. We are concerned that, as presently drafted, contributions during disability could be provided for under a plan during years when the only disabled participants are highly compensated and such provisions could then be deleted in subsequent years when the only disabled participants were nonhighly compensated.

Reports of Pension and Annuity Payments (Section 309, H.R. 2641; section 310, H.R. 2742)

Current Law

Persons maintaining or administering certain tax-favored retirement arrangements are required to file reports in the nature of information returns regarding the arrangements with the Internal Revenue Service and with the participants, owners, or beneficiaries under the arrangements. Under current law, failure to file the reports is subject to specific penalties rather than the generally applicable penalty for failure to file information returns.

Proposal

Under the bills, failure to file reports regarding tax-favored retirement arrangements that are in the nature of information reports would be subject to the generally applicable penalty for failure to file information returns. We note that the proposal is also contained in H.R. 2777.

Administration Position

We support this proposal as stated in prior testimony concerning H.R. 2777.

Disaggregation of Union Plans (Section 310, H.R. 2641)

Current Law

Under current law and regulations, union employees are excluded from consideration when testing plans covering nonunion employees for purposes of the minimum coverage rules and the nondiscrimination rules. Plans covering union employees are generally deemed to satisfy the minimum coverage rules and the nondiscrimination rules.

Proposal

The bill would permit an employer to elect to aggregate union with nonunion employees covered under the same plan on the same terms for purposes of the minimum coverage rules, the nondiscrimination rules and the separate line of business rules.

Administration Position

As stated above, we believe Congress should defer action until final regulations are published. The primary effect of the union disaggregation rule will relate to whether an employer can satisfy the coverage rules on the basis of the mechanical ratio/percentage test rather than on the basis of the average benefit percentage test. In connection with our review of comments received with respect to proposed regulations, we are considering the feasibility of a special rule to facilitate testing for coverage where an employer covers both union and nonunion employees under the same plan on the same terms.

Social Security Supplements (Section 311, H.R. 2641)

Current Law

Under current law and regulations, social security supplements are not subject to the anti-cutback rules of section 411(d)(6) (generally precluding elimination of certain retirement-type subsidies by plan amendment). Because of this lack of anti-cutback protection, the proposed nondiscrimination regulations do not permit social security supplements to be taken into account for purposes of the nondiscrimination rules. In the process of finalizing those regulations, we are actively exploring ways to permit such supplements to be taken into account if they are afforded anti-cutback protection.

Proposal

The bill would provide that any social security supplements (as defined) taken into account in testing most valuable accrual rates under the nondiscrimination rules would be subject to the anti-cutback rules as retirement-type subsidies. In addition, the bill would provide that social security supplements are disregarded in determining compliance with the permitted disparity rules.

Administration Position

While we believe that current law would permit us to accomplish this result administratively, we would not oppose a statutory provision subjecting certain social security supplements to the anti-cutback rules, provided social security supplements are appropriately defined.

Use of Basic or Regular Rate of Pay For Compensation (Section 313, H.R. 2641; section 103, H.R. 2742)

Current Law

Current law contains a definition of compensation for purposes, among others, of applying the nondiscrimination rules to qualified plans (section 414(s)). In addition to the basic statutory definition, the Secretary is authorized to provide alternative methods for determining compensation for these purposes. The temporary regulations implement this authority in two ways, most significantly by permitting employers to elect to use any reasonable definition of compensation subject to satisfaction of a nondiscrimination test. Basic or regular rate of pay is not specifically authorized under existing regulations.

Proposal

The bills would specify that the use of an employee's basic or regular rate of pay be included in the alternative methods for determining compensation prescribed by the Secretary under regulations.

Administration Position

As stated above, we believe Congress should defer action until the final regulations are published. During the comment period for the existing temporary and proposed regulations, employers discussed the possible addition of rate of pay as an alternative method for determining compensation. Of course, alternative methods for determining compensation must be nondiscriminatory. We are carefully considering these comments for possible inclusion in the final regulations. We believe this can be accomplished under the existing regulatory authority and that legislation in this area will not be necessary.

Transfers of Employees (Section 314, H.R. 2641)

Current Law

Benefits under a qualified plan are generally tested for nondiscrimination solely by reference to the benefits earned in the specific plan. An employer can elect, however, to aggregate two plans for purposes of nondiscrimination testing and for purposes of meeting the coverage requirements.

Proposal

Under the proposal, benefits provided under a plan would not be considered discriminatory merely because the benefit of employees who transfer between members of the same control group is based on all years of service with the employer offset by the benefit accrued under any other plan or plans of the employer.

Administration Position

As stated above, we believe Congress should defer action until the final regulations are published. During the comment period for the proposed regulations, many employers indicated that providing "wraparound" benefits for transferred employees was a common business practice that should be accommodated by the regulations. We are carefully considering these comments and possible ways in which the final regulations could facilitate use of this plan design feature.

Special Grandfather Rule for Integrated Plans (Section 315, H.R. 2641)

Current Law

Benefits and contributions under qualified plans are subject to nondiscrimination testing. Special rules permit a specified disparity in the amount of benefits or contributions, generally recognizing that employers also contribute to social security up to a specified level of compensation. The current rules relating to permitted disparity were adopted in the Tax Reform Act of 1986, generally effective in 1989. Proposed regulations relating to the permitted disparity rules permitted an employer to elect one of three transition methods, each of which allowed for continual adjustments in pre-1989 benefits due to post-1989 compensation changes, provided certain minimum standards were met.

Proposal

The bill provides that a plan is not discriminatory merely because an employee's accrued benefit is the sum of his or her accrued benefit as of the close of the 1988 plan year (but based on final average compensation as of the date of termination of service) plus his or her benefit accrued in years after 1988.

Administration Position

We oppose this proposal. The proposed regulations struck a balance between the employer's desire to maintain the final average compensation feature of pre-1989 benefits and the need to implement the new permitted disparity rules in accordance with the statutory modifications. We believe that if the pre-1989 benefits were allowed to increase along with compensation without any pre-conditions, then the effect of the 1986 Act changes would be severely undercut. For example, under the pre-1989 integration rules, a plan was permitted to provide no benefits with respect to compensation below the plan's "integration" level. As a result such plans provided little or no benefits to nonhighly compensated employees. We do not believe that increases in these benefits as a result of post-1988 compensation increases, which benefit increases will be limited predominately to highly compensated employees, are appropriate.

Determination of Employee Contributions Under Defined Benefit Plans (Section 316, H.R. 2641)

Current Law

Current law provides that, in the case of a defined benefit plan with mandatory employee contributions, the employee-derived benefit must be fully vested at all times. The employee-derived benefit is determined by converting the accumulated employee contributions plus interest into an annuity using PBGC interest rates. The accumulation of employee contributions is determined by crediting interest at 120 percent of the Federal mid-term rate as in effect during the first month of each plan year until the determination date and projecting forward at the PBGC interest rate to normal retirement age. The employee-derived benefit may exceed the total benefit under the plan formula.

<u>Proposal</u>

The bill provides for the use of the PBGC interest rate for purposes of determining the employee-derived accrued benefit under defined benefit plans providing for employee contributions. The bill also provides that, in general, the employee-derived accrued benefit will not exceed the employee's accrued benefit under the plan.

<u>Administration Position</u>

We do not support this proposal as a simplification measure at this time because the basis for determining the required interest rate has been changed twice in the last 4 years. We share the concern, however, that the interest that must be used currently may be too high.

We oppose the proposal to limit the employee-derived accrued benefit. An employee should always be entitled to a return of his or her own contributions plus interest.

<u>General Nondiscrimination Test Based on Rate of Accruals</u>
(Section 317, H.R. 2641)

<u>Current Law</u>

Current law provides that the contributions or benefits under a tax-qualified plan may not discriminate in favor of highly compensated employees. Under the current proposed nondiscrimination regulations, no highly compensated employee may receive a benefit greater than a benefit provided to nonhighly compensated employees. However, the proposed regulations permit the benefits and contributions under a plan to be "restructured" into component plans for purposes of the nondiscrimination test, provided each component plan covers a nondiscriminatory group of employees.

<u>Proposal</u>

The bill provides that a plan will be deemed nondiscriminatory if the average rate of accrual for highly compensated employees is not greater than the average rate of accrual for all other employees.

Administration Position

As stated above, we believe Congress should defer action until the final regulations are published. In response to comments received with respect to the proposed regulations, modifications to the restructuring rules are being made to facilitate nondiscrimination testing.

Separate Line of Business Rules (Section 318, H.R. 2641)

Current Law

Under current law, all employees of employers that are members of the same control group are treated as employed by a single employer for purposes of various employee benefit provisions under the Code. An exception to this general rule is provided if the employer operates separate lines of business. As a precondition for testing qualified plans on a separate-line-of-business basis, however, Congress required every plan of the employer to cover a nondiscriminatory classification of employees on an employer-wide basis. Current law also requires the Secretary to provide rules for allocating headquarters personnel among the lines of business of the employer and for the treatment of other employees who provide services for more than one line of business. In accordance with the legislative history, the proposed regulations do not generally permit headquarters to be treated as a separate line of business.

Proposal

The proposal would repeal the employer-wide nondiscriminatory classification test. The bill would also modify the rules relating to the allocation of headquarters personnel and other shared employees by providing that no employee is to be allocated to more than one line of business. In addition, the bill would permit headquarters to be treated as a separate line of business provided that at least 60 percent of the headquarters employees are not highly compensated. The Secretary would be directed to prescribe rules reducing the 60 percent requirement if the number of highly compensated headquarters employees is less than 85 percent of all the highly compensated employees of the employer.

Administration Position

We oppose repeal of the employer-wide nondiscriminatory classification test. We believe that the test is generally necessary to maintain the integrity of the coverage and nondiscrimination rules. However, we note that there may be some overlap between that requirement and other rules relating to the determination of whether an employer is operating qualified separate lines of business (e.g., the 50/200 statutory safe harbor for satisfying the administrative scrutiny requirement). In developing final regulations, we are considering the degree to which this overlap can be minimized.

With regard to the proposals to modify the allocation rules, we believe Congress should defer action until the final regulations are published.

Clarification that Section 457 Does Not Apply to Nonelective Deferred Compensation (Section 319, H.R. 2641)

Current Law

Unfunded deferred compensation plans of governmental and tax-exempt employers are subject to the provisions of section 457, which include an annual cap on benefits of $7,500 (or, if less, 33-1/3 percent of compensation). The provisions of section 457 apply to nonelective plans as well as plans providing for benefits or contributions at the election of the participant. The term "nonelective deferred compensation" would be defined by the Secretary in regulations.

Proposal

The bill would exempt nonelective plans from the requirements of section 457.

Administration Position

We do not support the provision. The proposal draws a fundamental distinction between "elective" plans and "nonelective" plans when, in practice, it is difficult to define the differences, particularly in the case of individually negotiated employment contracts.

Date for Adoption of Plan Amendments (Section 320, H.R. 2641; section 312, H.R. 2742)

Current Law

Plan amendments must generally be made by the end of the plan year in which the amendments are effective, although later amendments may be made if the remedial amendment period extends that date.

Proposal

The bills would provide that any plan amendments required by the legislation would not be required to be actually made before the 1993 plan year, provided the plan is operated in accordance with the amendment and the amendment is made retroactive.

Administration Position

We do not support this proposal. Absent appropriate circumstances, we believe a delayed date for actual plan amendments creates serious difficulties in the proper administration and operation of plans.

CONCLUSION

The bills before the Committee today identify a number of proposals which will provide meaningful simplification. Simplification proposals must meet the revenue constraints of the Budget agreement. Both the Administration's pension simplification proposals and H.R. 2730 achieve this result. H.R. 2641 and H.R. 2742 currently do not. However, given the number of similar provisions in these proposals, it is clear that revenue neutral pension simplification is attainable. We look forward to continuing our work with Congress to enact meaningful simplification of the employee benefit provisions of the Code.

Mr. Chairman, that concludes my formal statement. I will be pleased to answer any questions you or other Members may wish to ask.

TABLE I

REVENUE ESTIMATES OF ADMINISTRATION'S PENSION PROPOSALS

	(billions) 1992	1992-96
Distributions from Qualified Plans	.6	3.0
Cash or Deferred Arrangements (401(k) Plans)	-.1	-.6
Extend 401(k)'s to Tax-exempts	-*	-.2
Extend 401(k)'s to State and Local Governments	-.1	-1.2
Salary Reduction Simplified Employee Pensions	-.1	-.8
Definition of Highly-Compensated Employee	*	.3
Repeal of Family Aggregation Rules	-*	-.1
Multi-Employer Vesting	-*	-.1
Total	.3	.3

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* Less than $50 million

The estimates assume an effective date of 1/1/92.

Department of the Treasury
Office of Tax Analysis

July 24, 1991

TREASURY NEWS

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TEXT AS PREPARED FOR DELIVERY
EMBARGOED UNTIL 9:30 A.M.

Prepared Remarks of
Secretary of the Treasury
Nicholas F. Brady
For Press Conference to
Introduce Security-Enhanced Currency
July 25, 1991

Good morning. Today, we are introducing two new security-enhancements for U.S. currency. This marks another step in the continuing effort to ensure the security of America's paper money.

The greenback is the most trusted and widely held currency in the world. It is vital to the nation and essential to a sound global economy that we maintain that trust.

In 1862 when greenbacks were first issued to help pay for the Civil War, only six employees worked in the basement of this building making the money. Annual production the first two years was less than $2 billion. Today, more than $268 billion is in circulation world-wide. This year we'll produce more than 8 billion notes with a total face value exceeding $105 billion.

Back in the 1860s Treasury officials struggled with ways to protect the currency. In 1865 the Secret Service was created to suppress an extensive and serious counterfeiting problem. They searched the country over to identify paper and engraving techniques to thwart counterfeiters. One of the products of this effort was the embedding of red and blue fibers into the paper -- a feature that lives on in today's currency.

These fibers, the paper, and engraving are three of the nine security features that have protected our money for more than 100 years. The other six include: serial numbers; lifelike portraits; Federal Reserve and Treasury seals; and distinct borders and denomination markings.

These features work. In 1990 only $80 million in counterfeit notes were seized. This represents just one-tenth of one percent of total genuine yearly currency production, and only three one thousandths of one percent of world-wide circulation. Of the counterfeit notes, more than 80% were seized before they left the counterfeiters hands and were never passed to the public.

NB-1391

Today, we introduce two new security features in Series 1990 notes. They are subtle and nearly invisible to the naked eye. They were developed in anticipation of the widespread availability of advanced copying equipment -- it's important to stay ahead of technology. And the new features were chosen after extensive research and testing for effectiveness, durability and subtlety.

The first feature is a polyester security thread, embedded in the paper on the left of the portrait side of the note. It runs vertically between the border and the Federal Reserve seal and has USA and the denomination, in this case 100, printed in an alternating up-and-down pattern. The denominated strip can only be seen when the note is held up to a light source. Otherwise, it is so subtle that most people wouldn't notice it.

The security thread can't be copied with existing technology, which is a significant counterfeit deterrent. Copiers and scanners use reflected light that bounces off an image rather than shining through it. The polyester strip is embedded during the papermaking process rather than laid on the surface, making it difficult to see or copy with reflected light.

The other new security enhancement -- microprinting -- features the all-capitalized words, THE UNITED STATES OF AMERICA, printed repeatedly around the portrait. The letters, at six to seven thousandths of an inch, appear like a thin line to the naked eye. At about the thickness of the paper that currency is printed on, the microprinting is too small to read without a magnifier or for distinct copier reproduction. If a note is suspect, microprinting offers another method of checking for genuineness.

Since April, the Department of the Treasury has produced 250 million Series 1990 $100 notes worth $25 billion with the new security enhancements. We will be printing about 200 million additional notes per month. The Series 1990 $50 notes with the enhancements are scheduled for production by year's end. Within three to five years, all denominations will have the security thread and microprinting. The only possible exception is the $1 note, which does not pose a great counterfeiting risk.

With these new safeguards, potential counterfeiters with access to advanced color copiers, laser scanners and digital printing equipment will be greatly deterred from quickly and easily making bogus bills.

These advanced copying technologies are not yet generally available. In fact, counterfeiting of this kind is still very rare. Only $2 million in counterfeits seized last year were produced using this sophisticated copying equipment.

We retain full confidence in American currency -- with, or without the two new enhancements. The new security-enhanced notes will co-circulate with existing notes, which will be replaced by the Federal Reserve when they wear out or when enough of the enhanced bills are available.

Although the introduction of the security thread and microprinting places us ahead of the widespread use of advanced copier and printer technology, we must be vigilant and continue to provide protection against emerging techniques and potential counterfeit threats. Of equal importance in counterfeit deterrence is a public knowledgeable about its money and cash handlers skilled at recognizing counterfeits.

To ensure this, today we are launching an international campaign to inform the public, bankers, and retailers here and overseas about the enhancements in U.S. currency and the security design features that have long kept the U.S. dollar safe from widespread counterfeiting. Brochures, training materials for financial institutions, and posters are being distributed in the United States and worldwide. These educational materials have been translated into Japanese, Spanish, Portuguese, German, French, and Italian.

Now, I would like to turn the microphone over to Alan Greenspan, Chairman of the Federal Reserve Board, who will discuss the Federal Reserve System's plans for putting the enhanced currency into circulation. Chairman Greenspan.

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TREASURY NEWS

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FOR IMMEDIATE RELEASE July 25, 1991

Monthly Release of U.S. Reserve Assets

The Treasury Department today released U.S. reserve assets data for the month of June 1991.

As indicated in this table, U.S. reserve assets amounted to $74,940 million at the end of June 1991, down from $78,262 million in May 1991.

U.S. Reserve Assets
(in millions of dollars)

End of Month	Total Reserve Assets	Gold Stock 1/	Special Drawing Rights 2/3/	Foreign Currencies 4/	Reserve Position in IMF 2/
1991					
May	78,263	11,057	10,515	47,837	8,854
June	74,940	11,062	10,309	44,940	8,629

1/ Valued at $42.2222 per fine troy ounce.

2/ Beginning July 1974, the IMF adopted a technique for valuing the SDR based on a weighted average of exchange rates for the currencies of selected member countries. The U.S. SDR holdings and reserve position in the IMF also are valued on this basis beginning July 1974.

3/ Includes allocations of SDRs by the IMF plus transactions in SDRs.

4/ Valued at current market exchange rates.

NB-1392

AUCTION RESULTS

PUBLIC DEBT NEWS

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FOR IMMEDIATE RELEASE
July 25, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 52-WEEK BILLS

Tenders for $12,567 million of 52-week bills to be issued August 1, 1991 and to mature July 30, 1992 were accepted today (CUSIP: 912794YW8).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.86%	6.24%	94.075
High	5.88%	6.26%	94.055
Average	5.88%	6.26%	94.055

Tenders at the high discount rate were allotted 88%. The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	33,875	33,875
New York	33,045,085	11,534,725
Philadelphia	16,720	16,720
Cleveland	33,445	33,445
Richmond	32,250	32,250
Atlanta	18,280	17,280
Chicago	1,701,370	447,370
St. Louis	18,185	11,945
Minneapolis	6,035	6,035
Kansas City	32,095	32,095
Dallas	13,410	13,410
San Francisco	544,485	88,485
Treasury	299,240	299,240
TOTALS	$35,794,475	$12,566,875
Type		
Competitive	$32,031,805	$8,804,205
Noncompetitive	762,670	762,670
Subtotal, Public	$32,794,475	$9,566,875
Federal Reserve	2,850,000	2,850,000
Foreign Official Institutions	150,000	150,000
TOTALS	$35,794,475	$12,566,875

An additional $55,000 thousand of bills will be issued to foreign official institutions for new cash.

NB-1393

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
July 29, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,401 million of 13-week bills to be issued August 1, 1991 and to mature October 31, 1991 were accepted today (CUSIP: 912794XL3).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.56%	5.73%	98.595
High	5.58%	5.75%	98.590
Average	5.58%	5.75%	98.590

Tenders at the high discount rate were allotted 69%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	39,690	39,690
New York	33,254,475	9,038,710
Philadelphia	21,290	21,290
Cleveland	48,460	48,445
Richmond	49,720	44,720
Atlanta	27,880	27,570
Chicago	2,111,965	384,715
St. Louis	66,880	26,870
Minneapolis	8,105	8,105
Kansas City	49,655	49,655
Dallas	25,445	25,445
San Francisco	853,825	207,325
Treasury	478,535	478,535
TOTALS	$37,035,925	$10,401,075
Type		
Competitive	$33,355,730	$6,720,880
Noncompetitive	1,264,295	1,264,295
Subtotal, Public	$34,620,025	$7,985,175
Federal Reserve	2,046,500	2,046,500
Foreign Official Institutions	369,400	369,400
TOTALS	$37,035,925	$10,401,075

NB-1394

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STATEMENT OF
KENNETH W. GIDEON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON SELECT REVENUE MEASURES
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am pleased to present the views of the Administration on the tax-exempt bond simplification provisions of H.R. 2777, the Tax Simplification Act of 1991 and H.R. 2775, relating to additional tax simplification.

This is my third appearance in less than a week on simplification proposals. I will not repeat earlier testimony on the general benefits of simplification. We believe that Federal tax laws governing tax-exempt bonds can be simplified to the benefit of State and local government issuers without undercutting Federal tax policies limiting the utilization of such bonds to appropriate purposes. We are generally supportive of that effort. We are concerned, however, that sufficient revenue offsets be provided. The tax-exempt bond provisions of both H.R. 2777 and H.R. 2775 lose revenue. (See Table I.) Our expressions of support must be qualified by the requirement that simplification be revenue neutral.

NB 1395

ANALYSIS OF TAX-EXEMPT BOND PROVISIONS OF H.R. 2777, THE TAX SIMPLIFICATION ACT OF 1991

TITLE IV, SUBTITLE D

Repeal of $100,000 Limitation on Unspent Proceeds Under 1-year Exception from Rebate

Current Law

A tax-exempt bond is not subject to the arbitrage rebate requirement if all of the proceeds of the issue (other than proceeds in a reasonably required reserve and replacement fund and in a bona fide debt service fund) are spent for the governmental purpose of the issue within 6 months of the date of issue of the bond. In the case of non-private activity bonds and qualified 501(c)(3) bonds, the 6-month period is extended to 12 months if no more than the lesser of 5 percent of the proceeds of the issue or $100,000 is unspent after the first 6 months and such unspent amount is spent within the next 6 months.

Proposal

The condition that no more than the lesser of 5 percent or $100,000 remain unspent after 6 months would be changed to a requirement that no more than 5 percent of the proceeds remain unspent after 6 months.

Administration Position

We support this proposal. We believe that this proposal will simplify compliance with this exception to arbitrage rebate without compromising tax policy with respect to the arbitrage rebate requirement.

Exception From Rebate for Earnings on Bona Fide Debt Service Fund Under Construction Bond Rules

Current Law

Non-private activity bonds and qualified 501(c)(3) bonds issued to finance construction projects are exempt from the arbitrage rebate requirement if the bond proceeds are spent at specified percentages in 6-month intervals over a 24-month period beginning on the date of issue of the bonds. An issuer complying with the requirements of this exception under certain circumstances is still required to pay arbitrage rebate on arbitrage earnings attributable to a bona fide debt service fund.

Proposal

Earnings on a bona fide debt service fund, with respect to a bond issue that meets the spend-down requirements of the 24-month arbitrage rebate exception, would not be subject to the arbitrage rebate requirement.

Administration Position

We support this proposal. We believe that this proposal will simplify compliance with the arbitrage rebate requirement and that it is consistent with the policy behind the 24-month arbitrage rebate exception.

Automatic Extension of Initial Temporary Period for Construction Issues

Current Law

After the termination of the initial temporary period, bond proceeds invested at a yield materially higher than the yield on the bonds pursuant to such temporary period must generally be invested at a yield not in excess of the bond yield plus .125 percent.

Proposal

With respect to bonds issued to finance non-private activity construction projects, the initial temporary period would be automatically extended 1 year if, as of the end of the initial temporary period, the issuer had spent at least 85 percent of the bond proceeds available for construction and the issuer reasonably expected to spend the remaining bond-construction moneys within the following 12-month period.

Administration Position

We do not oppose this proposal. We agree that subjecting bond proceeds to yield restriction and rebate requirements at the same time is duplicative and that simplification in this area is desirable. We believe that the proposal made last year by the Congressional staffs -- to allow issuers to rebate arbitrage in lieu of restricting yield on investments under appropriate circumstances -- continues to be the most promising approach. We suggest that this rebate-in-lieu-of-yield restriction proposal be given further consideration as a means of simplifying the problem addressed by the current proposal. We would, however, request that the Treasury be given regulatory authority to require yield restriction when necessary in order to discourage arbitrage-motivated transactions.

Aggregation of Issues Rules Not to Apply to Tax or Revenue Anticipation Bonds

Current Law

The Internal Revenue Service in certain private letter rulings has treated multiple issues of bonds issued within 31 days of each other by the same issuer as being a single debt obligation for purposes of applying tax rules with respect to tax-exempt bonds. Tax and revenue anticipation notes (TRANs) are short-term borrowings by a governmental unit issued for the purpose of financing near-term cash flow deficits.

Proposal

The aggregation of TRANs with other non-private activity bond issues of an issuer would be prohibited regardless of when the TRANs was issued.

Administration Position

We do not oppose this proposal. We believe that this clarification will simplify compliance with relevant Federal tax requirements without compromising Federal tax policy in this area.

Authority to Terminate Required Inclusion of Tax-Exempt Interest on Return

Current Law

Section 6012(d) of the Internal Revenue Code requires that every person required to file a Federal income tax return for the taxable year must include on such return the amount of tax-exempt interest received or accrued during the year.

Proposal

The Secretary of the Treasury would be given authority to exempt taxpayers from reporting tax-exempt interest pursuant to section 6012(d) of the Code in any case in which the Secretary determines that the disclosure of such interest is not useful for tax administration.

Administration Position

We do not support this proposal. Given the need for this data in tax administration, we see little likelihood that this authority could be exercised to reduce issuer compliance burdens in any significant way.

Repeal of Expired Provisions

Current Law

A special exception to the arbitrage rebate requirement applicable to certain issues of qualified student loan bonds expired on December 31, 1988.

Proposal

Since the provision is no longer of any effect it would be repealed as deadwood.

Administration Position

We support this proposal. The provision is no longer needed.

ANALYSIS OF TAX-EXEMPT BOND PROVISIONS OF H.R. 2775, RELATING TO ADDITIONAL TAX SIMPLIFICATION

TITLE II

Repeal of Disproportionate Private Business Use Test

Current Law

A bond issued by a governmental unit is treated as a private activity bond (and therefore is generally not tax exempt) if more than 10 percent of the proceeds of the bond are used to benefit persons or entities other than governmental units or the general public (nongovernmental use is generally referred to as "private business use"). In addition, the 10 percent threshold is reduced to 5 percent in the event the private business use is not related to the governmental use of the facility being financed or the private business use is disproportionate to the different governmental uses in multi-governmental use projects (this is referred to as the "5 percent unrelated or disproportionate test").

Proposal

The proposal would repeal the 5 percent unrelated or disproportionate test.

Administration Position

We do not oppose this proposal. This portion of section 141 is often misunderstood by issuers and not easily administrable by the Internal Revenue Service. Repeal would accomplish significant simplification without sacrificing significant policy objectives.

Expanded Exception from Rebate for Issuers Issuing $10,000,000 or Less of Bonds

Current Law

Bond issuers with general taxing powers that issue, in the aggregate, less than $5 million of tax-exempt non-private activity bonds per calendar year are exempt from the arbitrage rebate requirement with respect to such non-private activity bonds issued during the year.

Proposal

The $5 million limit on qualification for small issuer status would be increased to $10 million.

Administration Position

We do not oppose this proposal. Increasing the number of small issuers that are exempt from the arbitrage rebate requirement should accomplish simplification objectives without opening the door for abuse of arbitrage. We would oppose any increase in the limitation above $10 million.

Repeal of Debt Service Based Limitation on Investment in Certain Nonpurpose Investments

Current Law

Generally, the amount of proceeds of private activity bonds (other than qualified 501(c)(3) bonds) invested at a yield materially higher than the bond yield may not exceed 150 percent of debt service on the bond issue. This limitation does not apply to bond proceeds invested at a materially higher yield pursuant to an initial temporary period or pursuant to a temporary period with respect to a bona fide debt service fund.

Proposal

The 150 percent of debt service limitation on the amount of private activity bond proceeds that could be invested at an unrestricted yield would be repealed.

Administration Position

We support this proposal. Because the arbitrage rebate requirement continues to apply to these bond proceeds, we believe that elimination of this requirement will result in significant simplification without permitting abuse involving arbitrage.

Election of Rebate Requirement After Initial Temporary Period

Current Law

Issuers must generally restrict the yield earned on the investment of bond proceeds to an amount not materially higher than the yield on the issue. There are exceptions to this rule, one of which is that bond proceeds may be invested at an unrestricted yield for an initial temporary period (usually 3 years and in some cases 5 years) pending expenditure of the bond proceeds. Another exception permits a reasonably required reserve or replacement fund (a 4R Fund) and certain sinking funds and replacement funds to be invested at an unrestricted yield. The arbitrage rebate requirement generally requires issuers to pay to the Federal Government virtually all arbitrage earned on the investment of bond proceeds even when the earning of such arbitrage is permitted by an exception to the general yield restriction rule described above.

Proposal

Bond issuers would be allowed to elect to pay arbitrage rebate only with respect to bond proceeds invested at an unrestricted yield pursuant to the 3-year (or in some cases 5-year) initial temporary period or invested in 4R Funds, sinking funds and replacement funds. If elected, an issuer would not have to pay arbitrage rebate with respect to bond proceeds not invested for an initial temporary period or in a 4R Fund, sinking fund or replacement fund but would be required to restrict the investment of such proceeds to the bond yield. Within 60 days of the termination of the initial temporary period issuers would pay all rebate due on those proceeds invested for the initial temporary period and no further rebate would be due with respect to those proceeds. Under certain circumstances the issuer would also be allowed to yield restrict proceeds in a reserve or replacement fund (instead of paying rebate on the arbitrage earnings with respect to such proceeds). The temporary period with respect to these funds (and any requirement to pay arbitrage rebate) would not be affected by this election.

Administration Position

We do not support this proposal. We do not believe this proposal accomplishes significant simplification. Issuers would continue to be required to comply with both the arbitrage rebate requirement and the arbitrage yield restriction requirement. In addition, terminating all rebate liability with respect to proceeds that are invested at an unrestricted yield pursuant to an initial temporary period, by allowing a rebate payment at the end of the temporary period, could lead to abuse. Abuse is possible because the actual yield to maturity on the bond issue would not be taken into account in computing the rebate payment. We prefer the approach described on page 3 of my testimony.

CONCLUSION

Mr. Chairman, Members of the Subcommittee, that concludes my formal statement. We welcome the opportunity to work with you to achieve meaningful and affordable simplification of the tax-exempt bond provisions of the Code. I will be pleased to answer any questions you or other Members may wish to ask.

TABLE I

REVENUE ESTIMATES OF TAX-EXEMPT BOND PROVISIONS OF H.R. 2777 AND H.R. 2775

	(millions) 1992	1992-96
H.R. 2777		
Title IV, Subtitle D	-1	-5
H.R. 2775		
Title II	-11	-111

Department of the Treasury
Office of Tax Analysis

July 22, 1991

TREASURY NEWS

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TEXT AS PREPARED
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Expected at 1:30 p.m.
Monday, July 29, 1991

TESTIMONY OF
WILLIAM E. BARREDA
DEPUTY ASSISTANT SECRETARY OF THE TREASURY
FOR TRADE & INVESTMENT POLICY
BEFORE THE
SUBCOMMITTEE ON TRADE
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
JULY 29, 1991

Thank you, Mr. Chairman. It is a pleasure to appear before this Committee and have the opportunity to discuss the Fair Trade in Financial Services Act of 1991.

The Treasury Department's views on this bill are well-known. After opposing this bill in its initial form, the Treasury worked with the sponsors to modify those parts which we found most objectionable. Treasury's primary objective was to obtain greater discretion and flexibility. As a result of these efforts, the provisions on financial services in the short-term extension of the Defense Production Act, S.468, were changed to respond to our concerns. Subsequently, the Treasury withdrew its opposition to that bill which has been introduced in the House as H.R. 991.

The sponsors felt strongly that such legislation would give U.S. negotiators new tools to ensure that U.S. financial firms receive fair treatment in international financial services. In fact, Treasury had noted in the 1990 National Treatment Study that: "Because of the movement towards reciprocity or reciprocal national treatment in many other industrial countries and the slow progress in achieving effective national treatment, especially in some Asian and Latin American financial markets, Members of Congress have raised the need for possible tools to increase the effectiveness of achieving U.S. policy objectives within the framework of national treatment and equality of competitive opportunity."

I would like to turn to some key background developments which are important to this legislation and Treasury's views regarding it. I will also address some questions posed by the Subcommittee.

NATIONAL TREATMENT IN THE UNITED STATES

First, I would like to reiterate the Treasury Department's belief that everyone benefits from open financial markets which are easily accessed by domestic and foreign participants. The benefits which accrue from competition in the financial services sector include increased liquidity, greater access to financing, lower cost of funds, and in general, a smoother functioning of financial markets. The strength, size and depth of U.S. financial markets certainly attest to such benefits.

The prevailing policy of the United States is to provide national treatment to foreign participants in the establishment and operation of financial institutions within the United States. For example, the International Banking Act of 1978 generally provides treatment for foreign banks that is no less favorable than that accorded U.S. banks in similar circumstances. The Administration's current banking modernization proposal has also adopted national treatment as its cornerstone regarding foreign and domestic banks.

The results of this national treatment policy are clearly evidenced by the significant presence of foreign financial firms in the United States. As of December, 1990, 294 foreign banks had 727 offices, with assets totalling $787 billion, approximately 21 percent of total U.S. commercial bank assets. Foreign banks provide 18 percent of total lending in the U.S. and nearly 31 percent of total business loans. In some areas the role of foreign banks is much larger. For example, foreign banks provide 61 percent of the business loans in New York and about 51 percent in California. Foreign banks have obviously benefitted from our open market policy as has the entire U.S. economy.

EFFORTS TO ACHIEVE NATIONAL TREATMENT ABROAD

The United States has also persistently pressed for open financial markets and national treatment abroad in both bilateral and multilateral fora. For example, the Treasury Department has been engaged in bilateral talks with Japan since 1984 to open Japanese financial markets and improve foreign firms' access. These discussions have resulted in greater opportunities for U.S. and other countries' financial firms in the government securities markets, on the Tokyo Stock Exchange, and in various activities such as trust banking and foreign exchange trading.

Treasury has held similar talks with Korea and Taiwan where we have achieved some limited progress in opening those markets. Negotiations with the Canadians four years ago resulted in a U.S.-Canadian Free Trade Agreement which contained significant liberalization measures for financial services. We hope to be able to extend liberalization with Mexico and Canada as part of the negotiations on a North American Free Trade Agreement (NAFTA). Discussions with the European Community have also been useful in clarifying the status of U.S. firms as the EC moves towards a single unified financial market in 1993.

In the OECD, Treasury has pressed for the principle of national treatment in various OECD agreements and has encouraged individual OECD member countries to adopt policies of open markets and national treatment.

In the Uruguay Round, the Treasury has been the U.S. Government agency responsible for negotiating a financial services agreement which would contain legally binding obligations calling for both market access and national treatment for financial institutions. We hope the Uruguay Round will improve financial services worldwide and lead to liberalization in a wide range of countries, particularly in the newly industrializing economies of Asia and Latin America.

While progress has been made over the years, the 1990 National Treatment Study, which the Treasury Secretary was required by the 1988 Trade Act to submit to Congress, demonstrated that U.S. firms continue to face difficulties in gaining access to many foreign markets. Significant progress was noted in Canada and in most European countries. However, the findings for other foreign financial markets were less satisfactory with regard to the ability of U.S. firms to participate fully and effectively.

Specifically, progress in Japan was found to be disappointingly slow and incomplete. In other Asian countries, such as Korea and Taiwan, progress was considered inadequate, with serious barriers to U.S. financial firms still existing. Significant denials of national treatment were also noted in Latin American countries such as Mexico, Brazil and Venezuela.

While the U.S. generally adheres to a policy of national treatment, many countries have moved toward a reciprocal national treatment policy whereby foreign firms are accorded national treatment only if the home country market of the foreign firm offers national treatment. In 1984, only 11 OECD members had reciprocity powers. By January 1993, at least 18 out of the 24 OECD members will have such powers available, including such major financial centers as Japan, the U.K. and Germany. The EC Second Banking Directive, which originally included a potential mirror image reciprocity provision, has also adopted reciprocal national treatment.

FAIR TRADE IN FINANCIAL SERVICES ACT

The movement towards reciprocity or reciprocal national treatment in many other industrial countries and the slow progress in achieving national treatment and equality of competitive opportunity have raised the issue of whether the United States needs additional policy tools to attain U.S. objectives. Some have called for a change in our fundamental policy of national treatment, such as that contained in the Fair Trade in Financial Services Act.

The bill provides authority for the Secretary of the Treasury to publish in the Federal Register a determination that a particular country denies national treatment to U.S. financial firms. After publication of such a determination, U.S. financial regulators may deny applications for financial activities, following appropriate consultation with the Secretary. The bill also requires the Secretary of the Treasury to initiate negotiations with countries where there are significant denials of national treatment for U.S. firms.

The Treasury Department initially opposed proposals to adopt a reciprocal national treatment policy because of concern that even limited reciprocity would involve the risk that sanctions would be imposed and that retaliation would follow. Such action could have a potentially serious impact on global financial markets. As I stated earlier, however, Treasury worked with the sponsors of the bill last year to inject greater discretion and flexibility in the bill.

Some questions have been raised concerning the operation of the Fair Trade in Financial Services Act.

Relationship to International Obligations

The United States has entered into, or is presently negotiating, a number of bilateral or multilateral agreements that contain detailed provisions aimed at improving foreign treatment of U.S. financial institutions. We have already entered into the U.S.-Canada Free Trade Agreement, which was approved by both Houses of Congress. We are currently negotiating financial services issues in the Uruguay Round and in the North American Free Trade Agreement and will be sending those agreements to both Houses of Congress when they are completed. The Fair Trade in Financial Services Act does not permit action to be taken which is inconsistent with our obligations under those agreements.

In considering proposed actions against unfair foreign practices, the Act also provides ample opportunity to evaluate the compatibility of such actions with other international obligations, such as treaties of friendship, commerce and navigation and bilateral investment treaties, prior to reaching a decision regarding the appropriateness of a proposed action. Because these treaties often contain most-favored-nation provisions, we cannot rule out the possibility that sanctions imposed under the Act might, in some cases, be inconsistent with international obligations under these agreements.

While we would not lightly take action inconsistent with our international obligations to deal with unfair foreign practices which might themselves violate international agreements, Treasury does not believe that the Executive should be denied this authority under domestic law. In this context, I might point out that Section 301 of the Trade Act of 1974 does not prohibit the Executive from imposing sanctions in response to unfair trade practices, even if such action would be contrary to international obligations.

Decision-Making

The Fair Trade in Financial Services Act carefully balances the need for expertise in the financial regulatory area possessed by the various bank regulatory agencies and the Securities and Exchange Commission with the overall expertise in foreign economic relations possessed by the Secretary of the Treasury. The Secretary, through the conduct of negotiations with the country denying national treatment to U.S. institutions, will be in a position to assess the likely effectiveness of proposed actions, and to advise the regulatory agencies accordingly. However, the bill does not compel the regulatory agencies to follow the advice of the Treasury Secretary.

The Act allows the Secretary to consider all relevant factors prior to deciding whether to publish a notice in the Federal Register stating that the country does not accord national treatment to U.S. financial institutions. Even after the Secretary has published this notice, the regulatory agencies may weigh various factors in formulating, in consultation with the Secretary, appropriate sanctions against the foreign country denying national treatment.

The factors that the bill specifically requires to be considered with respect to foreign financial institutions already operating in the United States are: (1) whether the foreign country has a record of according national treatment to United States financial institutions; and (2) whether that country would permit United States financial institutions operating in that country to expand their activities even if that country determined that the United States did not accord national treatment to that country's financial institutions. Furthermore, the regulatory agencies, in consultation with the Secretary, may further differentiate between entities already operating in the United States and entities not already operating in the United States, to the extent that such differentiation is consistent with achieving the overall goal of increasing U.S. access to foreign financial markets.

Relationship with Section 301

It has been suggested that the Fair Trade in Financial Services Act is unnecessary because it duplicates existing authorities under Section 301 of the Trade Act of 1974. However, for some time there have been other laws that address trade and investment practices which might also be actionable under Section 301. For example, countervailing duty procedures address foreign government subsidies, and Section 1912 of the Export-Import Bank Act Amendments allows the Export-Import Bank to match foreign export credits into the U.S. market that are inconsistent with OECD guidelines. The Mineral Lands Leasing Act of 1920 permits aliens, as stockholders in domestic corporations, to hold interests in mineral leases on federal lands, other than the outer continental shelf, only if the aliens' home country grants reciprocal rights to U.S. citizens.

While it is true that the Fair Trade in Financial Services Act builds upon some of the concepts of Section 301, the Act contains many features that are specifically designed to meet the unique requirements of financial services issues. In particular, the Act establishes procedures that are intended to strengthen Treasury's hand in financial market negotiations. The role of the Secretary should also diminish perceptions of arbitrariness that could disrupt financial markets.

Because of the variety of unfair and injurious foreign practices that take place in international trade in goods and services, Section 301 is broadly drawn to make actionable a wide spectrum of unfair foreign activities: violations of trade agreements or other denials of international rights, and practices that are "unreasonable" or "discriminatory" and burden or restrict U.S. commerce. By contrast, the Fair Trade in Financial Services Act is tightly drawn to target only denials of national treatment to specified financial sectors.

Procedurally, while USTR can self-initiate Section 301 investigations, most Section 301 investigations are initiated upon the request of a private petitioner. By contrast, the Fair Trade in Financial Services Act is directly linked to findings in the National Treatment Studies. Countries whose financial practices have been criticized in a Study are put on notice that they may be subject to sanctions should they fail to alter their practices. The Act gives the Secretary a flexible timetable to conduct negotiations, or impose sanctions.

Sanctions imposed under the Fair Trade in Financial Services Act are confined to the specific financial service sector in which the foreign country denies U.S. financial institutions national treatment. Although sanctions imposed under Section 301 could be in a sector unrelated to the sector in which the unfair foreign actions arose, such sanctions have generally been limited to related sectors.

CONCLUSION

To conclude, as I stated earlier, the Treasury Department has withdrawn its opposition to the Fair Trade in Financial Services Act of 1991 as contained in H.R. 991 since suggestions to inject greater discretion have been incorporated in that version. If the Congress considers it desirable that the Administration have the flexibility to take action specifically against denials of national treatment to U.S. financial firms abroad, then Treasury believes that the Fair Trade in Financial Services Act provides more appropriate leverage than Section 301.

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RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,447 million of 26-week bills to be issued August 1, 1991 and to mature January 30, 1992 were accepted today (CUSIP: 912794XX7).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.67%	5.93%	97.134
High	5.69%	5.96%	97.123
Average	5.69%	5.96%	97.123

Tenders at the high discount rate were allotted 51%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	33,245	33,245
New York	28,344,455	8,910,250
Philadelphia	16,115	16,115
Cleveland	38,605	38,605
Richmond	63,885	61,435
Atlanta	38,305	35,980
Chicago	2,239,940	491,190
St. Louis	42,945	25,480
Minneapolis	7,785	7,785
Kansas City	47,555	47,555
Dallas	16,850	16,850
San Francisco	561,565	87,065
Treasury	675,795	675,795
TOTALS	$32,127,045	$10,447,350
Type		
Competitive	$27,417,235	$5,737,540
Noncompetitive	1,362,810	1,362,810
Subtotal, Public	$28,780,045	$7,100,350
Federal Reserve	2,400,000	2,400,000
Foreign Official Institutions	947,000	947,000
TOTALS	$32,127,045	$10,447,350

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STATEMENT OF
THOMAS D. TERRY
BENEFITS TAX COUNSEL
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON EXPORTS, TAX POLICY AND SPECIAL PROBLEMS
COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to present the views of the Department of the Treasury on the classification of workers as employees or independent contractors for Federal tax purposes, and the impact of the classification rules on small businesses.

Overview

The proper classification of workers as employees or independent contractors has significance for both Federal employment tax and income tax purposes. Income taxes on employees are collected mainly by employers through the withholding system, whereas income taxes on independent contractors are collected mainly through self-assessment under the estimated tax system. Similarly, fringe benefits provided to employees are eligible for a number of tax preferences that are not available to independent contractors.

Worker misclassification results when taxpayers misapply the tests used to distinguish employees from independent contractors. Under long-standing Internal Revenue Service (IRS) procedures, the employment and income tax status of workers is generally determined by applying 20 factors derived from the common law.

Worker misclassification may be either inadvertent or deliberate. Inadvertent misclassification may occur when taxpayers lack sufficient guidance to determine a worker's correct classification. Deliberate misclassification may occur when taxpayers try to exploit differences in the treatment of employees and employers, on the one hand, and independent contractors and their clients, on the other, for Federal tax or other purposes. Current Federal tax law does not consistently favor status as either an employee or an independent contractor. Depending on individual circumstances, however, misclassification may sometimes be advantageous to the worker, his client or employer, or both.

NB-1398

The IRS increased its employment tax enforcement activities in the late 1960's, when independent contractors faced a much lower Social Security and Medicare tax rate than the combined rate for employers and employees. There was a substantial increase in the reclassification of independent contractors as employees, sometimes resulting in large retroactive employment tax assessments against employers. Taxpayer complaints led Congress to enact section 530 of the Revenue Act of 1978 (section 530), which provides statutory relief for certain employers and prohibits the IRS from issuing regulations or revenue rulings addressing the status of individuals as employees or independent contractors for employment tax purposes. In section 1706 of the Tax Reform Act of 1986 (section 1706), Congress removed the statutory relief of section 530, but only for taxpayers who broker the services of technical services workers--engineers, designers, drafters, computer programmers, systems analysts and other similarly-skilled workers engaged in a similar line of work.

Policy issues relating to the reclassification of technical services workers covered by section 1706 were discussed in a recent Treasury Department report to the Congress, Taxation of Technical Services Personnel: Section 1706 of the Tax Reform Act of 1986 (March 1991) (Treasury Report). The Treasury Report was prepared in response to section 6072 of the Technical and Miscellaneous Revenue Act of 1988, which directed the Secretary of the Treasury to conduct a study of the treatment provided by section 1706.

The Treasury Report addressed the five specific issues raised about section 1706 in the Conference Report to the 1988 Act as follows:

- Administrability of section 1706. The Treasury Report found that section 1706 presents few administrative problems and improves administrability of classification by partially repealing the prohibition on guidance in section 530. It also found that the types of occupations covered by section 1706 could be clarified.

- Abuses in reporting income by independent contractors. The Treasury Report found that there are errors in classification which may produce revenue losses and may call for administrative or legislative changes; that the revenue losses may be offset to some extent by the differences in the tax treatment of fringe benefits; and that technical services workers generally have higher compliance rates than other independent contractors.

- Chilling effect of section 1706 on the ability of technical services personnel to get work. The Treasury Report found that section 1706 may have had transitory effects but probably little, if any, permanent effect.

- Administrability of the present law standards for classifying individuals as employees or independent contractors. The Treasury Report found that the current rules can be difficult to apply; that section 530 has exacerbated this problem by prohibiting the IRS from issuing guidance; and that section 1706 has helped by permitting the IRS to issue guidance for certain workers.

- Equity of distinguishing between independent contractors who work through brokers and those who do not. The Treasury Report found that the distinction unnecessarily limits the beneficial effects of section 1706, possibly reducing the efficiency of labor markets for such workers, but that data were not available to determine whether the distinction can be justified by differences in compliance rates.

Sources of Employee Misclassification

Inadvertent Misclassification. A wide variety of relationships between workers and businesses exists in the modern economy. They differ with respect to the degree of control exercised by the business, whether the services are full-time or part-time, the method of compensation (e.g., salaried versus hourly), the level of material support provided by the business, and many other factors. Nevertheless, for Federal tax purposes, workers must generally be grouped into one of two broad categories: employees and independent contractors.

As indicated above, the status of a worker as an employee or independent contractor for purposes of Federal employment, income and other tax laws is, with few exceptions, determined under the common law tests for determining whether an employment relationship exists. These tests focus on whether the business has the right to direct and control the worker, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished.

The common law tests, like most facts-and-circumstances tests, lack precision and predictability. Despite years of effort by many talented people, however, no clearly better definition has ever been developed. In the absence of a better definition, the best alternative is improved guidance with respect to the existing rules.

Section 530 generally prohibits the IRS from issuing regulations or publishing revenue rulings addressing the status of workers as employees or independent contractors for employment tax purposes, however. Labor markets have undergone significant changes since the enactment of section 530 in 1978, during which time the IRS has been unable to issue any general guidance reflecting its interpretation of the common law tests. This has made it difficult for taxpayers and IRS personnel alike to analyze employment relationships consistently, and has reduced employers' ability to predict when the common law tests require a particular worker to be treated as an employee or independent contractor. For this reason, one of the legislative options for further consideration described in the Treasury Report was to repeal the prohibition in section 530 against IRS issuance of guidance concerning employee status.

Deliberate Misclassification. As noted above, current law does not consistently favor status as either an employee or an independent contractor. Employers and employees are treated differently than independent contractors and their clients under a number of Federal and State laws, however. Thus, depending on individual circumstances, misclassification may sometimes be advantageous.

Prior to 1982, compensation earned by independent contractors was taxed at substantially lower rates under the Social Security and Medicare tax provisions of the Internal Revenue Code than wage income, creating a significant incentive for misclassification. Subsequent legislation has essentially eliminated this important difference. The Social Security, Medicare, and income tax provisions of the Internal Revenue Code may still favor classification as an independent contractor, however, where a worker has a small or variable cash flow or significant employee business expenses. This is primarily because independent contractors face significantly fewer restrictions on their ability to deduct trade or business expenses than employees. Also, the estimated tax system used to collect Social Security, Medicare, and income taxes from independent contractors largely avoids the problem of over-withholding that can result when an employee incurs large business expenses, has net income that fluctuates during a year, or is employed for only part of a year.

Independent contractors may also have more opportunity than employees to be less than fully compliant with the tax laws. Employees are subject to withholding, and the amount of their wage income is reported with great precision to the IRS. Independent contractors may be able to omit some of their income on their tax returns. Under-reporting of income becomes more difficult when an independent contractor's gross income is reported to the IRS on information returns. Even if an independent contractor reports 100 percent of his income, however, he may be able to reduce his reported tax liability by overstating deductible expenses.

The unemployment insurance tax provisions of the Internal Revenue Code and corresponding State laws, and State and Federal labor and related laws, e.g., workers' compensation requirements, may in some cases also favor classification as an independent contractor. This is because employees may not value coverage under these laws as highly as the associated tax or other costs, and can avoid the costs by reclassifying their status as that of an independent contractor.

The Social Security, Medicare, and income tax provisions of the Internal Revenue Code may, on the other hand, favor classification as an employee in cases where a worker prefers to receive some of his compensation in the form of fringe benefits rather than cash. This is because, under the Internal Revenue Code, an employer may provide fringe benefits, such as pensions, accident and health and group-term life insurance, on a tax-favored basis to its employees but not to its independent contractors. Such benefits are generally excluded from employees' gross incomes subject to income tax as well as wages subject to Social Security and Medicare taxes. While independent contractors can generally establish their own fringe benefit plans, amounts used to purchase such benefits generally cannot be deducted or excluded from gross income subject to income tax, or from compensation subject to Social Security and Medicare taxes. Certain of the most significant benefits, including pensions and accident and health insurance, may be available to independent contractors on a limited basis, however. Amounts used to purchase these benefits can, to some extent, be deducted or excluded from gross income subject to income tax by independent contractors, although they cannot be deducted or excluded from compensation subject to Social Security and Medicare taxes.

The various differences in tax treatment between employees and independent contractors discussed above are summarized in Tables 1 and 2, attached hereto.

<u>Impact of IRS Reclassification Generally</u>

The IRS is charged with enforcing most Federal tax laws. As a result, it is often required to determine whether a worker has been correctly classified as an employee or an independent contractor. Where the worker has not been correctly classified, the worker and his client or employer may be assessed back taxes, interest, and penalties. This is generally true even if the misclassification was inadvertent. For example, the penalties for late deposit of withheld income and FICA taxes generally apply regardless of fault.

Prior to 1982, when the IRS reclassified a worker as an employee, the employer was generally held liable for the full amount of unwithheld income taxes and the unwithheld employee share of Social Security and Medicare taxes for all years open under the statute of limitations. In addition, the employer remained liable for Federal unemployment insurance tax and the employer share of Social Security and Medicare taxes. Penalties and interest could also be assessed. Therefore, the employer's liability for under-withholding could be abated only if the employer could prove that the employee had paid income and Social Security and Medicare taxes on the compensation received by the reclassified worker.

In 1982, section 3509 was added to the Internal Revenue Code to mitigate the problem of large retroactive employment tax assessments in reclassification cases. Section 3509 generally limits an employer's liability for failure to withhold income, Social Security or Medicare taxes on payments made to a worker whom it misclassified as an independent contractor to 1.5 percent of the wages paid to the individual plus 20 percent of the employee portion of Social Security and Medicare taxes on those wages. If the employer did not comply with the information reporting requirements associated with the treatment of an individual as an independent contractor, these percentages are doubled to 3.0 and 40 percent, respectively. Section 3509 has no effect on an employer's own liability for Federal unemployment insurance taxes or the employer portion of Social Security and Medicare taxes. Also, in exchange for limiting the employer's liability for failure to withhold employee taxes, section 3509 prohibits the employer from reducing its liability by recovering any tax determined under the section from the employee, and gives the employer no credit for any income taxes ultimately paid by the employee. Section 3509 does not apply in cases of intentional disregard of the withholding requirements.

Congress has also provided general statutory relief from IRS reclassification of employees as independent contractors for certain taxpayers. Section 530 of the Revenue Act of 1978, mentioned above, prohibits the IRS from challenging an employer's treatment of a worker as an independent contractor for employment tax purposes if the employer (1) has a reasonable basis for such treatment and (2) consistently treats the individual, and any other individual holding a substantially similar position, as an independent contractor. Reasonable reliance on any of the following is treated as a reasonable basis for this purpose:

- judicial precedent, published rulings, or letter rulings or technical advice memoranda issued to, or with respect to, the taxpayer;
- a past IRS audit in which there was no assessment attributable to the employment tax treatment of the individual or of individuals holding positions substantially similar to that of the individual; or
- a long-standing recognized practice of a significant segment of the industry in which the individual was engaged.

Relief may also be available if the taxpayer can show some other reasonable basis for its treatment of a worker. Section 530 does not merely provide relief from retroactive assessments: as long as the two requirements are met with respect to a worker, the IRS is prevented from correcting an erroneous classification of that individual, even prospectively.

Section 530 applies solely for purposes of the employment tax provisions of the Internal Revenue Code (e.g., Social Security, Medicare, unemployment insurance taxes, and income tax withholding). It does not affect a worker's classification as an employee for income tax purpose.

Impact of Reclassification on Small Business

Studies suggest that smaller employers may misclassify a larger percentage of their employees. Thus, the impact of IRS reclassification, particularly retroactive reclassification, could be greater for a typical small business than for a typical larger business. We believe that the prohibition in section 530 against the issuance of guidance by the IRS concerning employment status contributes significantly to the misclassification of employees by small businesses. Removing this prohibition, as suggested by the Treasury Report, could make it possible for the IRS to issue guidance which small businesses need to comply with the tax rules.

Conclusion

To conclude, worker misclassification is a long-standing and difficult problem of tax policy, which the Treasury is very interested in seeing resolved. The Treasury Report suggests several options for further consideration and analysis. We would be pleased to work with the Subcommittee to develop these ideas further.

Mr. Chairman, that concludes my formal statement. I will be pleased to answer any questions that you or other Members may wish to ask.

Table 1

Tax-Favored Benefits Available to Employees and Independent Contractors

	Availability		
Benefits	**To Employee in Employer's Plan**	**To Independent Contractor in Client's Plan**	**To Independent Contractor in Own Plan**
Employee achievement awards[a]	May be required		
Group-term life insurance[b]	May be required		
Death benefits[c]	Generally optional		
Accident and health insurance[d]	Generally optional		Limited deduction only
Tuition remission[e]	May be required		
Meals and lodging[f]	Optional		
Group legal services[g]	May be required		Optional
Cafeteria plans[h]	May be required		
Educational assistance[i]	May be required		Optional
Dependent care[j]	May be required		Optional
No-additional-cost fringes[k]	May be required		Optional
Qualified employee discounts[l]	May be required		Optional
Working condition fringes[m]	Optional	Optional	Optional
De minimis fringes[n]	Generally optional	Optional	Optional
Free parking[o]	Optional		Optional
On-premises athletic facilities[p]	Optional		Optional
New-product testing[q]	Optional		Optional
Qualified pensions and annuities[r]	May be required		Optional
Tax-sheltered annuities[s]	May be required		
Qualified and incentive stock options[t]	Optional		
Employee stock purchase plans[u]	May be required		
Voluntary employees' beneficiary associations[v]	May be required		

Department of the Treasury
Office of Tax Policy

In this table, "optional" means that the benefit is not required to be provided under any minimum coverage or nondiscrimination rules, while "may be required" means that it may have to be provided.

Notes

a. Code §§ 74(c) and 274(j)(3)(B).

b. Code § 79(d); Treas. Reg. § 1.79-0(b).

c. Code § 101(b)(3)(A); Treas. Reg. § 1.101-2(f)(1). Discrimination rules may apply if the benefits are provided under a qualified pension plan, however.

d. Code §§ 105(g), 106, and 162(1)(1); Treas. Reg. § 1.105-1(a). Coverage and discrimination requirements may apply if the plan is self-funded. Code § 105(h).

e. Code § 117(d)(2)(A).

f. Code § 119.

g. Code § 120(c)(1), (c)(2) and (d)(1).

h. Code § 125(b)(1) and (d)(1)(A); Prop. Treas. Reg. § 1.125-1, Q&A-4.

i. Code § 127(b)(2) and (c)(2); Treas. Reg. § 1.127-2(h)(1)(iii).

j. Code § 129(d)(2), (d)(3), (d)(8) and (e)(3).

k. Code § 132(b), (f) and (h)(1); Treas. Reg. § 1.132-1(b)(1) and (3).

l. Code § 132(c), (f) and (h)(1); Treas. Reg. § 1.132-1(b)(1) and (3).

m. Code § 132(d); Treas. Reg. § 1.132-1(b)(2) and (4).

n. Code § 132(e); Treas. Reg. § 1.132-1(b)(2) and (4). Certain nondiscrimination rules apply to eating facilities, however.

o. Code § 132(h)(4); Treas. Reg. § 1.132-(b)(2) (flush language).

p. Code § 132(h)(5); Treas. Reg. § 1.132-1(b)(1) and (3).

q. Treas. Reg. §§ 1.132-1(b)(2) (flush language) and 1.132-5(n).

r. Code §§ 401(a)(4), 401(c) and 410(b); Treas. Reg. §§ 1.72-17(a) and 1.401-10(b).

s. Code § 403(b); Treas. Reg. § 1.403(b)-1(a)(1).

t. Code §§ 421-22A; Treas. Reg. § 1.421-7(h).

u. Code § 423; Treas. Reg. § 1.423-2(e)(2).

v. Code § 501(c)(9); Treas. Reg. § 1.501(c)(9)-2(b).

Table 2

Major Differences in Treatment of Employees and Independent Contractors for Federal Tax and Other Purposes

Employees	Independent Contractors
Fringe Benefits[1]	
Value of many employer-provided fringe benefits excluded from income and employment tax bases	Qualified retirement plan contributions excluded from income but not self-employment tax base
	25 percent of health insurance costs deducted from income but not self-employment tax base
	Few other fringe benefits excluded from income or self-employment tax bases
Trade or Business Expenses	
May be deducted from income tax base only by itemizers and only to the extent expenses exceed two percent of adjusted gross income	May be deducted from income tax base
May not be excluded from employment tax base	May be excluded from self-employment tax base
Certain expenses subject to additional business purpose requirements	
Administrative Costs	
Withholding involves more administrative costs for employer but less for employee	Estimated tax system involves more administrative costs for independent contractor but less for client
	Estimated tax system allows modest delay in tax payments relative to withholding
Compliance	
	Somewhat more ability to be noncompliant due to lack of withholding, larger trade or business expenses, and somewhat more limited business purpose requirements with respect to such expenses
Non-Tax Differences[2]	
Less flexibility in choosing among fringe benefits; value of employer contributions to retirement plan may be lost if worker changes jobs frequently	May be unable to obtain fringe benefits, including statutory fringe benefits such as unemployment insurance and workers' compensation
Administrative (and other) costs associated with Federal and State laws applicable to employees, *e.g.*, minimum wage	May be unable to negotiate worker protections such as minimum wage and overtime

Department of the Treasury
Office of Tax Policy

1. For a detailed comparison of the tax treatment of fringe benefits and business expenses, *see* Appendix A. Employer-provided fringe benefits may be subject to nondiscrimination requirements and other limits.

2. Some of the non-tax differences, such as minimum wage laws, may be more applicable to less advantaged workers than to occupations covered by section 1706.

TREASURY NEWS

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

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
Bucharest, Romania
July 30, 1991

Contact: Barbara Clay
(202)566-5252

US TREASURY OFFICIAL ANNOUNCES EXPANDED ASSISTANCE TO ROMANIA

U.S. Treasury Deputy Secretary John E. Robson today announced a further expansion of U.S. technical assistance to Romania. Robson's announcement followed two days of meetings in Bucharest with top Romanian officials, members of opposition political parties, and representatives of the private sector. "We know the road to democracy and a market economy is not an easy one, and in the end, success can only be accomplished by the continued strong commitment and participation of the Romanian people," said Deputy Secretary Robson. "President Bush and the American people want the people of Romania to know that we support their courageous efforts, and we will continue to support and assist them as they implement the difficult but crucial reforms and changes ahead."

Areas of expanded U.S. assistance which Deputy Secretary Robson discussed with Romanian officials included: training for commercial bank personnel; tax policy and administration; stock exchange operations; agri-business; implementation of privatization; and health care.

Robson's announcement followed a U.S. delegation visit which included meetings with President Iliescu, Prime Minister Roman, Finance Minister Dijmarescu, and opposition party leaders. The U.S. delegation also included Dr. Carol Adelman, Assistant Administrator for Eastern Europe with the Agency for International Development (AID). The purpose of the Robson delegation's visit was to further ongoing U.S. efforts to provide assistance in line with the specific needs of Romania. Deputy Secretary Robson serves as one of three coordinators designated by President Bush to oversee all U.S. assistance to East and Central Europe.

While in Bucharest, Robson and Adelman also presented a joint $12 million U.S. assistance grant to the Bucharest Polytechnic Institute and the Academy of Economic Studies. "This grant will help strengthen business education programs at the Romanian institutions and will help develop a small business assistance program. These two areas of education are fundamental to Romania's successful and lasting transition to a market economy," said Dr. Adelman. Two U.S. universities will work jointly with the Romanian institutions in this management training project.

The U.S. delegation leaves Bucharest tomorrow for meetings with top government officials in Albania.

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NB-1392

TREASURY NEWS

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DEPT. OF THE TREASURY

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

FOR RELEASE AT 2:30 P.M. July 30, 1991

CONTACT: Office of Financing 202/376-4350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $ 20,800 million, to be issued August 8, 1991. This offering will provide about $ 1,625 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $ 19,170 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Monday, August 5, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Daylight Saving time, for competitive tenders. The two series offered are as follows:

91 -day bills (to maturity date) for approximately $ 10,400 million, representing an additional amount of bills dated May 9, 1991 and to mature November 7, 1991 (CUSIP No. 912794 XM 1), currently outstanding in the amount of $ 8,620 million, the additional and original bills to be freely interchangeable.

182 -day bills for approximately $ 10,400 million, to be dated August 8, 1991 and to mature February 6, 1992 (CUSIP No. 912794 XY 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 August 8, 1991. 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 $ 1,670 million as agents for foreign and international monetary authorities, and $ 5,033 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

NB-1400

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 one-half hour prior to the closing time for receipt of tenders 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 competitive 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.

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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

8/89

TREASURY NEWS

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

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JUL 31 1991 0 0 5 9 1

DEPT. OF THE TREASURY

OPENING STATEMENT OF

JOHN P. SIMPSON

DEPUTY ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY

BEFORE THE

SENATE FINANCE COMMITTEE

UNITED STATES SENATE

JULY 30, 1991

NB-1401

Mr. Chairman:

I am pleased to join my colleagues this morning to discuss with you administration of the U.S.-Canada Free Trade Agreement. This hearing is particularly timely in that we are now beginning negotiation of a North American Free Trade Agreement that will be based on our free trade agreement with Canada.

In order to discuss how the U.S.-Canada Free Trade Agreement works with respect to trade in goods, and specifically how rules of origin operate, it may be useful to review briefly some earlier U.S. trade laws. Over the last twenty-five years, Congress has enacted several laws that require goods entering the U.S. to be treated differently according to their national origin. Some of these laws impose penalties or restrictions, for example, trade and financial sanctions, quotas, or special higher duties. Other laws extend preferential treatment, for example, the Generalized System of Preferences (GSP), the Caribbean Basin Economic Recovery Act (commonly referred to as the Caribbean Basin Initiative, or CBI), and the U.S.-Israel Free Trade Agreement.

Congress has consistently made clear its interest in seeing these laws administered in a manner that achieves the objectives

Congress intended. Goods produced in countries on which sanctions have been imposed should not avoid those sanctions. On the other hand, where Congress has extended special benefits to products of certain countries, those benefits should be extended only to goods produced in the countries Congress intended to benefit, and should not slip over to products of nonbeneficiary countries.

Administration of these laws is relatively easy when dealing with goods that originate wholly in a country that is the target of sanctions or the recipient of benefits. An example of this is agricultural products grown in that country's soil or minerals extracted from its mines. However, administrative problems are greater when a target country's products are further manufactured in another country, or when a target country further manufactures the products of a non-target country. We do not want a country subject to sanctions to circumvent those sanctions by having its products subjected to superficial processing in another country. Nor do we wish to see countries to which we have not extended preferential treatment effectively enjoy those benefits by having their products superficially processed in a beneficiary country.

Consequently, in order to achieve these objectives, we have adopted a policy that products of a country <u>remain</u> products of that country unless they undergo processing in another country that results in a substantial change in their character, or, as our courts have said, a substantial transformation.

Until enactment of the U.S.-Canada Free Trade Agreement in 1989, Congress never provided specific rules for defining substantial transformation. Traditionally, substantial transformation has been defined on a case-by-case basis by the U.S. Customs Service, using principles developed in opinions issued by our courts. Such an approach is necessarily highly subjective and the results have been inconsistent. Moreover, the courts have occasionally issued opinions, particularly some involving imports of iron and steel products, that appear to many to be in conflict with the intent of Congress in enacting laws regarding iron and steel trade.

It was apparently in an effort to guard against origin determinations that fail to meet its expectations that Congress, in enacting laws granting tariff preferences, introduced a new criterion for identifying products of a beneficiary country: a value-content requirement. The value-content requirement may set a ceiling on the value of nonbeneficiary-country materials contained in a product - examples of this are found in the insular possessions preference law and in the Automotive Products Trade Agreement with Canada - or the value-content requirement may set a minimum value for beneficiary-country materials and labor contained in a product, as is the case with GSP, CBI, and the U.S.-Israel Free Trade Agreement.

In 1987, when we began negotiation of a free trade agreement with Canada, we recognized the need to devise a better method for defining the term "substantial transformation" for the purpose of identifying goods qualifying for preference under the FTA. For many reasons that I shall not go into here, we rejected the idea of defining substantial transformation on the basis of value added or value content. Instead, we borrowed and, I believe, improved on, a European idea of defining substantial transformation in terms of change in tariff classification.

Substantial transformation defined by tariff classification change is the primary basis for determining the origin of goods under the U.S.-Canada Free Trade Agreement. However, for a limited number of product sectors the FTA does require in addition to a change in tariff classification that at least half of the cost of producing goods eligible for preference be attributable to the value of U.S. and/or Canadian materials and labor. We imposed this requirement only where the Harmonized System was insufficiently detailed to support construction of a rule of origin based on tariff classification, or where a particular industry insisted on having a value-content requirement.

One of the product sectors where we included the supplemental value-content requirement is the automotive sector. Our previous experience with preferential trade in automotive products was the Automotive Products Trade Agreement, or APTA. As implemented by the United States, APTA allowed duty-free access for automobiles and certain automotive parts provided that not more than 50 percent of their value was attributable to foreign materials.

There was fairly widespread dissatisfaction with the APTA rule because it was believed not to require a sufficiently high level of U.S. or Canadian content. One of the reasons for this was that there was no restriction on what could be counted as U.S. or Canadian content. Because of this, items such as profit, advertising and sales promotion, administrative costs, and executive incentives could all be counted as Canadian content. This reduced the need to utilize actual Canadian or U.S. parts and labor.

Consequently, a primary objective in drafting the free trade agreement with Canada was to strengthen the rule of origin for automotive products. We did this in several ways. First, we scrapped the APTA approach to valuecontent, which merely places a limit on foreign content, and replaced it with a positive requirement for U.S. and Canadian materials and actual labor, which was the approach we had used in GSP, CBI, and the

U.S.-Israel FTA. This effectively disallowed counting profit, sales promotion, and like costs as qualifying content.

And second, we reduced the inconsistency of results that the GSP/CBI type of value-content requirement produces by substituting total cost of manufacturing in place of customs value in the denominator of the equation. This means that regardless of changes in shipping costs or profit levels the denominator stays the same.

Finally, we raised the qualifying threshold from the 35 percent used in GSP/CBI to 50 percent. The result was a value-content requirement that was substantially more rigorous than that provided by APTA. As an aside, I might note that we are seeking to have this requirement increased to 60 percent if the value-content test is left in its current form.

It goes without saying that our experience with GSP and CBI did not adequately prepare us for a free trade agreement involving trade of the magnitude and complexity that we have with Canada. This is particularly true for automotive trade. Many of the principles and procedures that work well in trade with Caribbean countries are inadequate for automotive trade between the U.S. and Canada. We are learning some of these lessons from our audits of companies doing business under the FTA. We are benefitting from this experience, and we are applying the lessons we are learning both to seek modifications to our free trade agreement with Canada and to devise improved rules for the NAFTA.

In the meantime, we shall need to sort out problems that we discover, either through our audits or through other means, and take appropriate corrective action. And in doing that we shall need to distinguish between problems that result from a manufacturer's failure to comply and problems that result from shortcomings of the FTA itself.

I know the Committee has a particular interest in Treasury's role in Customs enforcement of the FTA. Treasury has both a policy making and oversight responsibility with respect to Customs issues, including its enforcement activities. We in Treasury are very supportive of Customs enforcement activities, and especially of Customs' efforts to enhance its commercial enforcement capabilities, particularly its audit function. We work collaboratively with Customs on enforcement matters, especially when such matters involve important or precedential policy issues. Because our experience in administering the U.S.-Canada Free Trade Agreement will undoubtedly influence our negotiation of a North American Free Trade Agreement, we are especially interested in having Customs bring to our attention any audit matters that appear to raise broad issues.

Mr. Chairman, this concludes my formal remarks. I shall be happy to answer any questions you or the members of the Committee may have.

Thank you.

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

FOR IMMEDIATE RELEASE July 30, 1991

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of June 1991.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $185.1 billion on June 30, 1991, posting an increase of $2.5 billion from the level on May 31, 1991. This net change was the result of increases in holdings of agency debt of $2,765.5 million and in agency-guaranteed loans of $196.1 million, while holdings of agency assets decreased by $415.2 million. FFB made 29 disbursements during June.

FFB began lending to the Federal Deposit Insurance Corporation on June 3, 1991.

FFB holdings on June 30, 1991 were the highest in the Bank's history.

Attached to this release are tables presenting FFB June loan activity and FFB holdings as of June 30, 1991.

NB-1402

FEDERAL FINANCING BANK

JUNE 1991 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
EXPORT-IMPORT BANK					
Note #98	6/3	$ 67,000,000.00	9/3/96	7.275%	7.210% qtr.
Note #99	6/3	14,700,000.00	6/2/03	8.113%	8.278% ann.
Note #100	6/3	988,000,000.00	12/2/91	6.072%	
FEDERAL DEPOSIT INSURANCE CORPORATION					
Note FDIC 0001					
Advance #1	6/3	2,900,000,000.00	7/1/91	5.823%	
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
Note #553	6/14	13,000,000.00	8/13/91	5.878%	
Note #554	6/21	3,000,000.00	8/20/91	5.857%	
Note #555	6/24	8,000,000.00	9/23/91	5.879%	
+Note #556	6/28	6,000,000.00	8/27/91	5.847%	
RESOLUTION TRUST CORPORATION					
Note RTC 0010					
Advance #2	6/10	300,000,000.00	7/1/91	5.855%	
TENNESSEE VALLEY AUTHORITY					
Short-term Bond #101	6/6	371,000,000.00	6/17/91	5.869%	
Short-term Bond #102	6/10	389,000,000.00	6/24/91	5.857%	
Short-term Bond #103	6/17	351,000,000.00	6/30/91	5.878%	
Short-term Bond #104	6/24	331,000,000.00	7/10/91	5.857%	
Short-term Bond #105	6/30	375,000,000.00	7/16/91	5.847%	

+rollover

FEDERAL FINANCING BANK

JUNE 1991 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Philippines 11	6/21	$ 13,261,259.49	3/12/93	6.362%	
Philippines 11	6/26	5,049,272.00	9/13/93	7.109%	
GENERAL SERVICES ADMINISTRATION					
Foley Square Office Building	6/3	641,496.00	12/11/95	7.799%	
Foley Square Courthouse	6/17	653,458.00	12/11/95	8.060%	
American National Bank & Trust					
Advance #1	6/26	156,735,134.00	6/28/21	8.561%	
U.S. Trust Company of New York					
Advance #14	6/10	536,411.29	11/15/91	6.079%	
Advance #15	6/27	1,509,567.40	11/15/91	6.034%	
DEPARTMENT OF HOUSING & URBAN DEVELOPMENT					
Oakland, CA	6/13	336,000.00	9/1/04	8.397%	8.573% ann.
RURAL ELECTRIFICATION ADMINISTRATION					
Western Farmer Electric #196A	6/3	5,000,000.00	12/31/15	8.244%	8.161% qtr.
*Sho-Me Power #164	6/5	650,000.00	12/31/19	8.371%	8.285% qtr.
*Basin Electric #232	6/12	449,000.00	1/2/24	8.549%	8.460% qtr.
Western Illinois Power #294	6/12	398,000.00	1/2/18	8.490%	8.402% qtr.
KAMO Electric #209A	6/25	1,824,000.00	6/30/93	7.079%	7.017% qtr.
Arizona Electric #242A	6/26	8,622,000.00	6/30/93	7.159%	7.096% qtr.
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-91-08	6/28	622,242,790.09	9/30/91	5.873%	

*maturity extension

FEDERAL FINANCING BANK
(in millions)

Program	June 30, 1991	May 31, 1991	Net Change 6/1/91-6/30/91	FY '91 Net Change 10/1/90-6/30/91
Agency Debt:				
Export-Import Bank	$ 11,238.0	$ 11,180.5	$ 57.5	$ -101.9
Federal Deposit Insurance Corporation	2,900.0	-0-	2,900.0	2,900.0
NCUA-Central Liquidity Fund	79.9	52.9	27.0	23.3
Resolution Trust Corporation	58,208.0	57,908.0	300.0	16,726.3
Tennessee Valley Authority	12,881.0	13,400.0	-519.0	-1,501.0
U.S. Postal Service	6,400.6	6,400.6	-0-	-297.2
sub-total*	91,707.5	88,942.0	2,765.5	17,749.6
Agency Assets:				
Farmers Home Administration	52,254.0	52,669.0	-415.0	205.0
DHHS-Health Maintenance Org.	66.9	66.9	-0-	-2.7
DHHS-Medical Facilities	82.7	82.7	-0-	-0-
Rural Electrification Admin.-CBO	4,463.9	4,463.9	-0-	56.7
Small Business Administration	6.8	7.0	-0.2	-1.6
sub-total*	56,874.3	57,289.5	-415.2	257.4
Government-Guaranteed Loans:				
DOD-Foreign Military Sales	4,702.2	4,699.5	2.7	-5,053.4
DEd.-Student Loan Marketing Assn.	4,850.0	4,850.0	-0-	-30.0
DHUD-Community Dev. Block Grant	218.6	219.1	-0.5	-25.4
DHUD-Public Housing Notes +	1,903.4	1,903.4	-0-	-47.4
General Services Administration +	646.5	491.5	154.9	279.1
DOI-Guam Power Authority	29.1	29.1	-0-	-0.7
DOI-Virgin Islands	24.7	24.7	-0-	-0.5
NASA-Space Communications Co. +	32.7	32.7	-0-	-1,063.2
DON-Ship Lease Financing	1,624.4	1,624.4	-0-	-47.9
Rural Electrification Administration	18,894.3	18,878.5	15.8	-148.0
SBA-Small Business Investment Cos.	296.9	296.9	-0-	-85.6
SBA-State/Local Development Cos.	706.1	712.4	-6.3	-35.5
TVA-Seven States Energy Corp.	2,418.7	2,389.2	29.5	62.7
DOT-Section 511	21.8	22.0	-0.1	-1.5
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	36,546.4	36,350.4	196.1	-6,197.3
grand total*	$ 185,128.3	$ 182,581.9	$ 2,546.3	$ 11,809.8

*figures may not total due to rounding
+does not include capitalized interest

TREASURY NEWS

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July 31, 1991

TESTIMONY OF
THE HONORABLE NICHOLAS F. BRADY
SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TELECOMMUNICATIONS AND FINANCE
OF THE
HOUSE COMMITTEE ON ENERGY AND COMMERCE

July 31, 1991

Good morning Chairman Markey, Mr. Rinaldo, and members of the Subcommittee and full Committee.

As you may know, my background includes 33 years in the securities industry competing with commercial banks and acting as financial advisor and underwriter to many of the nation's industrial companies. I have also spent nine months in the U.S. Senate and now nearly three years as Secretary of the Treasury. As a consequence of this experience, I am especially pleased to appear before you today to discuss the pressing need to strengthen and modernize our nation's banking and financial services laws. The plain fact is that the laws on the books no longer reflect the way financial companies do business. Until we recognize this and act, our financial system will be exposed to further decay. Our financial companies will become weaker; overseas financial companies will gain at our expense; and taxpayers will face the prospect of losses as weak financial concerns turn to the government for help.

In short, we must instead find ways to tap voluntary private capital from the marketplace to stand ahead of the taxpayer. That is the strategy at the heart of comprehensive banking and financial reform. It is the strategy behind H.R. 1505, the "Financial Institutions Safety and Consumer Choice Act of 1991." And it is the strategy behind H.R. 6, which is now before this Committee for its consideration.

NB-1403

At your request, my testimony today concentrates on issues related both to banking and securities activities and to the ability of banks to tap capital from outside the banking industry. Let me say at the outset, however, that these are only two aspects of the comprehensive legislation that is now before Congress. The legislation also decreases the exposure of the federal safety net, provides prompt corrective action for troubled banks, reduces the riskiness of activities funded with insured deposits, and permits increased efficiency through nationwide banking and branching.

Taken as a whole, the legislation addresses the fundamental problems of the banking system -- rather than just funding them. We believe it is a carefully balanced, integrated approach, which is essential to meaningful reform. By contrast, a thin, piecemeal approach is likely to push our most pressing problems into the future and could well defeat the very purpose of the legislation -- to strengthen the banking and financial system and better serve consumers. For example, merely recapitalizing the bank insurance fund would only delay the day of reckoning.

Banks will not be the only beneficiaries. Mutual funds and insurance companies will better serve their customers through a broader distribution network. And securities firms will be able to offer their customers loans through affiliated banks.

Let me now focus on the subject of today's hearing, beginning with an explanation of why we believe the laws governing the permissible affiliations of banks require fundamental change.

Need for Reform

Today's banking and financial laws are designed for a rigidly segmented financial system where different types of firms specialize in different types of financial activities that are insulated from competition. This is the picture that many people still have of our financial system: banks offer checking accounts and make business loans; thrifts offer savings accounts and make home mortgage loans; securities firms sell only securities products; insurance companies sell only insurance policies; and commercial companies stay out of financial activities altogether. According to this view, our laws are designed to stop these firms from competing with each other.

This may be a nice, neat picture, but it is at odds with reality. Both corporate and individual consumers have demanded change, and the marketplace has responded. Take securities firms, for example. Today they provide money market funds, credit cards, and check-writing privileges that compete directly with traditional bank products. They even sell federally-insured deposits directly to customers. At the same time, traditional corporate lending by banks has been supplanted by the development of the commercial paper and securities markets, which allow corporations to use securities firms to borrow directly from financial markets at lower rates.

The situation with insurance companies is similar. They, too, sell insured deposits directly to their customers, and they also offer securities-related products like variable annuities. At the same time, many of their lending activities compete directly with bank lending activities.

The nature of banking has changed, too. Banks now have the ability to engage directly or indirectly in a broad range of securities activities, although with numerous restrictions. They can engage with few limits in underwriting and dealing in U.S. government and agency securities, general obligation municipal securities, agency-guaranteed mortgage-backed securities, certain kinds of municipal revenue bonds, private placement activities, discount and full service brokerage, and financial advisory services. National banks are also permitted to securitize loans that they have originated or purchased. Moreover, banks may serve as advisers to mutual funds, and some of their trust activities involving pooled investments are very similar to mutual fund activities.

More recently, bank holding companies have been permitted to establish subsidiaries under Section 20 of the Glass-Steagall Act that derive a portion of their revenue from a wide range of otherwise prohibited securities activities, including the underwriting of corporate debt and equity. Banks also have gradually expanded into a limited number of insurance activities, beginning with credit life insurance and extending to title insurance, municipal bond insurance, fixed rate annuities, insurance agency activities in small towns, and a much broader range of activities within certain states.

Finally, in contrast to perhaps the most widely held misconception, banks have been able to affiliate with securities, insurance, and commercial companies through a variety of laws, regulatory interpretations, and court decisions. Likewise, commercial and diversified financial firms have long been permitted to acquire thrift institutions. The result is that a number of major diversified financial companies are in business today, engaging in all the activities that many people still believe are rigidly segmented into different industries.

These firms include General Electric, John Hancock, Sears, American Express, Ford, Merrill Lynch, Household Financial, and a number of major insurance companies. For example, Sears owns an FDIC-insured bank, a securities firm, and an insurance company; engages in consumer lending and commercial lending; provides credit cards and mortgage banking; and offers mutual funds to customers. American Express offers the same broad lines of business, including a bank with approximately $10 billion in assets, the country's second largest securities firm, the second largest mortgage company, and the largest credit card issuer. These are just two of many examples, but they graphically illustrate the point.

Another popular myth is that smaller community bankers only engage in traditional banking activities, and have no connection with other kinds of financial or commercial activities. This is just not the case. For example, many community banks are expressly authorized by law to engage in a wide range of insurance and other kinds of financial activities. More important, an individual today can own or control a bank and any other kind of financial or commercial business -- like the local car dealership or insurance agency, for example -- with virtually no restrictions on transactions between the insured bank and these other businesses or their customers. This common ownership of smaller banks and commercial companies is a widespread practice throughout the country.

Finally -- and this is particularly important to keep in mind -- the integration of banking and financial activities is accelerating in virtually all of the world's major industrialized countries, and their governments are putting in place rational regulatory structures to allow these activities to take place safely and profitably. For example, the European Community has decided in its "EC 1992" program to allow a banking organization to engage in a full range of financial services throughout its member countries. Recently, Japan has shown signs of modifying the legal segmentation of its financial businesses. These changes can only add to a trend that I know disturbs us all -- American financial institutions are finding it increasingly difficult to compete internationally.

Looking at the evidence of financial integration both at home and abroad, the question is why is this happening? I believe the answer is clear: consumers want this integration, and diversified financial companies are providing it because it is more profitable, more efficient, and safer than engaging in a single line of business. The know-how that a company develops in one line of financial business can be applied successfully to other related financial activities. It is only natural for a financial company to seek to capture the benefits of engaging in such activities, and to pass the savings -- in time and money -- on to the consumer.

Unfortunately, our regulatory structure is unable to keep up with this powerful trend in the market. Certainly, there have been some accommodations through regulatory interpretations, court decisions, state action, and piecemeal Congressional action, which together have permitted the blurring of financial activities described above. But our "system" is so laced with limitations and inequities that it creates tremendous inefficiencies that hamstring our most innovative competitors.

Why should a big bank be allowed to underwrite corporate equities, while a smaller bank can't distribute mutual funds to its customers? Why should an insurance company be allowed to sell bank deposits, while most banks can't sell insurance? Why should some banks be allowed to sell insurance, while insurance companies can't distribute their products through bank branches? Why should banks be allowed to underwrite general obligation municipal bonds, but not municipal revenue bonds? Why should commercial companies be allowed to infuse voluntary capital into troubled thrift institutions, saving the taxpayer billions of dollars, while these same companies are prohibited from providing this same capital to failing banks? These anomalies are hard to rationalize, yet they form the antiquated mosaic of our banking laws. And their existence imposes very real costs that we should no longer ignore.

In previous testimony I have focused on the costs of these restrictions to banking companies. Of all financial firms, banks have the most restrictions on the range of their activities, affiliations, and ability to tap private capital. At the same time, innovation and competition from firms that are not subject to these restrictions have eroded the value of the banks' traditional franchise. One of the steadiest and most reliable profit opportunities for banking businesses -- high grade commercial lending -- has migrated to the securities markets, where most banks are prohibited from competing. As a result, weaker banks have reached for riskier activities within their traditional lines of business, and we are all now faced with the consequences -- excessive commercial real estate lending, loans to less developed countries, and highly leveraged transactions. Because of the possibility of federal liability for bank losses through deposit insurance, the causes and cures for these problems are of particular concern. And the current credit crunch makes clear that there is an obvious national interest in maintaining a system of strong banks that can lend to credit-worthy customers in good times and bad.

Perhaps most troubling is the fact that our regulatory structure is simply no longer adequate to address the inexorable changes that have already taken place. We need more functional regulation. We need to demand higher bank capital for insured depositories that affiliate with companies engaged in a broad range of activities. And we need a rational structure with appropriate firewalls. If these needs are addressed, as they are in the legislation, the risk to the system will be greatly reduced.

Fundamentally, I believe we have to choose between a system that has the capacity to attract sufficient private voluntary capital and one that does not. Trying to maintain the status quo -- by muddling through with national "policy" set haphazardly by courts, regulators, and state legislatures -- is not an attractive option. This approach might cause few immediate problems, but the long-term effect would be serious. In reality, there will be no "status quo," so long as consumers and the marketplace demand movement towards financial integration. Instead of a steady state, international competitors would continue to gain at American firms' expense. Outdated legal barriers would continue to limit the flow of private capital into the banking system, with the possibility that taxpayers' public capital might have to take up the slack. Sound, functional regulation would be limited. Turf wars would continue among interest groups, with examples of unfair competition in every direction. Finally, banks and financial companies could become weaker.

It would be far preferable to finally recognize the reality of market forces; to adopt new laws that foster broad, fair, and safe competition in financial services; to tap all sources of voluntary private capital; and to rebuild a strong, vital banking system that continues to fuel economic growth. The House Banking Committee has adopted this approach in legislation now before this Committee, and with some changes, I believe this legislation would put the American banking system well on its way to recovery.

Let me now describe the relevant details of this approach that you have indicated are of the most interest to your Committee.

The Proposed Legislation

Both the Administration's proposal, H.R. 1505, and the House Banking Committee bill, H.R. 6, would allow banks to affiliate with financial firms through the formation of financial services holding companies (FSHCs). Commercial companies -- in practice, firms that are most likely to be primarily financial firms -- would in turn be permitted to own these new FSHCs by forming diversified holding companies (DHCs). (See Exhibit 1) This proposed structure would create a level playing field that permits banking, financial, and commercial companies to affiliate with each other on fair terms. Moreover, both bills include strong safeguards to prevent an expansion of deposit insurance and the federal safety net to cover new activities, and strong safeguards to protect consumers from abusive practices. (Because of the similarities between the two bills, references to the legislation below refer to both, unless otherwise noted.)

This legislation would benefit not just banking organizations, but a broad range of financial companies, including securities and insurance companies. It would enable these companies to capture the benefit of providing a broad range of financial products to retail and corporate consumers, as well as diversifying risk. For example, banks and securities and insurance companies would have new customer markets to tap and new distribution networks available to sell their products and services. The resulting competition is likely to create direct benefits for consumers, including lower costs and greater convenience.

As mentioned above, this blurring of distinctions between banking, financial, and related products is neither a new nor a radical idea. The legislation merely recognizes these changes and puts in place a regulatory structure that permits more comprehensive and more efficient "functional" regulation of financial activities. We believe this structure will improve the regulation of all financial activities conducted in a diversified holding company.

In addition, the legislation allows banks to tap all aspects of the United States financial markets for new sources of capital. Permitting diversified financial companies to own banks -- so long as the companies commit to strong bank capital levels -- will strengthen the banking system and reduce taxpayer exposure.

Safeguards

Obviously, there must be strong safeguards attached to the ability of banks to affiliate with a broader range of companies. These safeguards must ensure that the federal safety net does not cover new activities and expose the taxpayer to undue risk. They must also ensure that funding advantages of insured depositories are not used to subsidize new financial activities to compete unfairly with nonbank financial firms. A brief description of the safeguards in the proposed legislation is set forth below.

Safety net confined to bank. Only the bank would have access to deposit insurance, the Federal Reserve's discount window, or the federal payments system; the securities or insurance affiliate, the FSHC, or the DHC would have no such access. In this way the federal safety net is confined strictly to the bank, and taxpayer exposure would be limited to the losses of the bank, not of its affiliates.

Capital. Only banks with the highest capital level may affiliate with securities, insurance or commercial firms. If capital falls below the highest level, the bank must sever connections with any commercial firm and divest all securities and insurance activities.

Separately Capitalized Affiliates. Securities and insurance activities must be conducted in separately capitalized affiliates. Thus, failure of the affiliate will not affect the capital or safety of the bank.

Functional Regulation. Securities and insurance activities would be supervised by securities and insurance regulators. This ensures regulatory continuity and expertise and avoids multiple bodies regulating the same activities. It is my understanding, however, that the Banking Committee decided to eliminate many of the functional regulation provisions. We strongly urge the Committee to restore these provisions.

Funding Firewalls. The proposed legislation expands the types of transactions that are covered by existing rules limiting transactions between banks and affiliates. These rules limit the total amount of such transactions, mandate adequate collateral, and require arm's-length terms. Moreover, regulators must receive advance notice of any large transaction with an affiliate. Finally, regulators have broad authority to adopt additional funding firewalls.

"Firebreak" Between Banking and Commercial Firms. Firewalls between banks and commercial firms are even stronger than between banks and other affiliates. There would be a flat prohibition on extensions of credit and transfers of assets, even on arm's-length terms.

Customer Protection and Disclosure. Sales of a banking group's own securities would be prohibited on bank premises. Existing restrictions on "tying" the bank's products have been expanded to cover products of all affiliates, not just the bank. And banks and their affiliates must get written acknowledgment that their customers understand that securities and insurance products have no guarantee from the bank or the government.

In sum, the safeguards and firewalls described are a comprehensive, effective set of restrictions that will prevent the potential abuse of relationships between banks and their affiliates. However, we have not extended firewalls to include specific limitations on the sharing of management, employees, officers, or directors. Such limitations can restrict and impede operational, managerial, or marketing synergies between a bank and its affiliates without conferring any additional benefits for the federal safety net.

Before concluding, let me make two observations. First, you have asked whether affiliations with securities and insurance firms will solve all of the problems of banking organizations. Of course not. These activities will not be a panacea. But I strongly believe they will help restore the viability and durability of financial institutions; that an enhanced franchise will attract more private, voluntary capital into the financial system; and that affiliation between securities firms and banks could produce new firms better able to compete with overseas financial firms.

Second, you have no doubt heard and will continue to hear that this legislation amounts to the "S&Ls all over again." This is simply not the case. Banks are vastly different from thrifts. By a wide margin, banks have been better capitalized, better managed, and better regulated than thrifts. To be precise, banks have over $200 billion in equity capital, plus another $50 billion in reserves. Thrifts had less than $10 billion in equity in 1987, the year losses mushroomed.

In addition, the approach to reform set forth in the legislation is distinctly different from what was done with the S&Ls. Thrifts were permitted to use federally insured deposits to engage in risky activities inside the insured institution. If effect, we let thrift owners go to the casino with Uncle Sam's checkbook in hand. By contrast, this legislation would allow new financial activities to take place only outside the bank in separately capitalized affiliates, with stringent firewalls and strict supervision. And the bill goes even further in limiting new activities only to banks that exceed minimum capital requirements by a substantial amount.

Conclusion

It is important that we not learn the wrong lesson from the specter of the thrift problem. It would be ironic if memories of the thrift cleanup prevent us from making common sense changes that will attract voluntary private capital to the system.

We believe the comprehensive approach to financial services reform embodied in both the Administration's bill and H.R. 6 is critical to placing our banking and financial system on a safe financial footing over the long run. With your help, we can adopt such an approach.

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TREASURY NEWS

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STATEMENT BY
HOLLIS S. MCLOUGHLIN
ASSISTANT SECRETARY
FOR POLICY MANAGEMENT
U.S. DEPARTMENT OF TREASURY
BEFORE THE COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
July 31, 1991

Mr. Chairman and members of the Committee, I appreciate the opportunity to discuss the role that the Treasury Department has played in the burden sharing initiative to defray the costs of Operations Desert Shield and Desert Storm.

The Treasury Department has participated in an interagency effort along with the Department of State, the Defense Department, the National Security Council (NSC) and the Office of Management and Budget (OMB) to generate strong financial support from our allies. We have received support from our allies and coalition partners which has significantly reduced the budgetary cost to the American people of our efforts in the Gulf.

Allied commitments to the United States for 1990 and 1991 total nearly $54 billion. To date, we have received over $46 billion in cash and in-kind assistance from Germany, Japan, Saudi Arabia, Kuwait, the United Arab Emirates and Korea. This level of sharing the responsibility for the costs of military operations is unprecedented and demonstrates a solid international commitment to the successful efforts of the U.S.-led coalition to counter Saddam Hussein's aggression against Kuwait.

Treasury has helped to generate this support through its contacts with foreign officials and its on-going active participation in interagency consultations. As early as September 1990, Treasury Secretary Brady and Secretary of State Baker personally consulted a number of our allies in Europe, Asia and the Gulf region to discuss support for U.S. military actions in the Gulf.

I would like to comment specifically on Japan's commitment, as this issue was raised in the Committee's letter of invitation. In January, Finance Minister Hashimoto told Secretary Brady that Japan would contribute $9 billion to help offset incremental Desert Storm costs incurred in January-March 1991. We had asked that the entire $9 billion be in dollars and be disbursed to the United States. The Administration reported Japan's commitment to the Congress on this basis.

NB-1404

Subsequently, Japan advised us that we had misunderstood its precise commitment. Japan said that it had intended all along to disburse part of its 1991 commitment to other coalition partners, as it had in 1990, and believed that this would be acceptable to the U.S.

On July 11, President Bush met with Prime Minister Kaifu and concluded that the difference in understanding was reasonable and that Japan's payments were made in good faith with the agreed commitment. The President indicated that "any differences that might have existed...have been resolved."

To date, Japan has contributed just under $10 billion to the U.S. to offset our military costs in 1990 and 1991. In addition, Japan has committed almost $1 billion to other multinational coalition partners, bringing its total contribution to the burden sharing effort to nearly $11 billion. These substantial payments ~~represent~~ a ~~sizeable~~ portion ~~of this successful~~ burden sharing ~~effort~~.

Mr. Chairman, I would be happy to respond to any questions you or members of the Committee might have.

DEPARTMENT OF THE TREASURY
WASHINGTON

U.S. Treasury Department Staff Analysis of the Economic Strategy Institute's Report, "Foreign Investment in the United States: Unencumbered Access"

July 1991

Attached is an analysis of the Economic Strategy Institute's report, "Foreign Investment in the United States: Unencumbered Access." That report sets forth a number of concerns and criticisms about the operation of the Committee on Foreign Investment in the United States. The staff analysis addresses these concerns and criticisms.

CFIUS OPERATIONS

Concern: Because the Committee on Foreign Investment in the United States (CFIUS) has reviewed 540 transactions, but only investigated twelve and blocked one, "it is clear that the intent of Congress is not being carried out."[1]

Response: The success of CFIUS in implementing Exon-Florio should not be judged by whether it has met some quota for blocking or undertaking extended investigations of a certain percentage of transactions. As we will illustrate in several examples, CFIUS' impact goes far beyond simple statistics. CFIUS enhances the national security when it identifies specific problems which could threaten U.S. security and helps resolve those problems while still allowing U.S. businesses to receive the capital they need. Blocking a transaction is a crude tool and serves no purpose when more subtle remedies are available. CFIUS enhances the national security by ensuring that U.S. and foreign businesses conform with other national security laws before they submit notifications to CFIUS. Viewed from this perspective, CFIUS has been very successful.

As many are aware, Congress did not intend the blocking authority of Exon-Florio to supplant existing laws to protect the national security, but to be used in those highly unusual transactions where the President finds that:

"(1) there is credible evidence...to believe that the foreign [investor] might take action that threatens to impair the national security, and

(2) [existing laws do not] provide adequate and appropriate authority...to protect the national security..."[2]

Often CFIUS has found the authority of other laws adequate to protect national security, and thus did not need to use Exon-Florio authority to block or to undertake a 45-day investigation.

CFIUS agencies have become extremely efficient in analyzing transactions so most transactions can be dealt with using existing laws and a thorough 30-day review. If CFIUS can obtain the information it needs and conform the transaction to existing laws and regulations in 30-days, subjecting transactions to an additional 45-day review only further burdens U.S. businesses without enhancing the national security.

As noted above, CFIUS has also reviewed many transactions in which it identified problems and possible solutions. Such problems were not, in and of themselves, reason enough to prohibit the transactions. In such cases, the parties to the transactions withdrew

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[1] Spencer, Linda, <u>Foreign Investment in the United States: Unencumbered Access</u>, Economic Strategy Institute, p. 4. (1991). (Hereinafter cited as Spencer.)

[2] 50 U.S.C. sec. 2170(d) (1988) (currently lapsed).

their notice. The transactions were later resubmitted to CFIUS after the identified problems had been corrected. Sometimes, parties have been able to resolve problems within the 30-day review period without having to withdraw their notification.

CASE STUDIES: HOW CFIUS AFFECTS TRANSACTIONS WITHOUT BLOCKING

Case #1: Ensuring Proper Security Arrangements

One of the first cases CFIUS considered under Exon-Florio concerned a foreign buyer that was unaware that the small firm it sought to purchase held a highly classified contract with a government agency. When the prospective buyer became aware of the contract, it worked with the proper government authorities to isolate the contract work from foreign influence and control. Government agencies that engage in classified contract work require that such procedures be followed.

Towards the end of the CFIUS review, the contracting agency informed CFIUS staff that they had not concluded a satisfactory security arrangement with the buyer. CFIUS informed both parties that it would recommend that the President prohibit the transaction unless a proper security arrangement was in place.

As this was the only national security problem identified, and since a solution was in sight, CFIUS consented to having the parties withdraw their notice without approving the transaction. This permitted the foreign buyer to continue to develop a proper security arrangement with the government agency but allowed CFIUS to keep its authority to block the transaction if this work were not successful. After several weeks of negotiations between the parties and the government agency, CFIUS was informed by that agency that the party had set up an appropriate security arrangement. The buyer then resubmitted its notification to CFIUS. As no other factors in the transaction had changed, CFIUS approved the transaction. While this case was not blocked, *CFIUS helped resolve a potential national security problem within the context of existing law and regulations.*

Case #2: Determining Control, Bringing in Other Agencies

A similar situation involved the purchase of a small firm that manufactured equipment under a classified contract for the Federal government, and for foreign space entities. This transaction also illustrates other issues which CFIUS commonly confronts in its reviews.

Although the parties notified CFIUS of the transaction, they claimed that the buyer's purchase of only 20 percent of the voting stock of the acquired company did not constitute control according to the definition in the proposed regulations.[3] Treasury and Defense Department attorneys examined the proposed structure of the new entity and determined that

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[3] 54 Fed. Reg. 29,751 (July 14, 1989) (section 800.213).

the foreign buyer would have control according to the criteria of the draft regulations.

The U.S. firm being acquired had a contractual relationship with the National Aeronautics and Space Administration (NASA). As in all cases which involve an agency that is not a permanent CFIUS member, CFIUS immediately contacted its liaison with NASA and sought its full input in the CFIUS process. CFIUS asked NASA about the nature of work the acquired firm was providing and whether it had any national security concerns which could not be addressed by existing law.

The firm being acquired was also performing classified work for a branch of the armed services. Though negotiations had been underway to reach a security arrangement that would isolate foreign influence or control, the parties to the transaction were unable to do so as the Exon-Florio clock approached the 30th day of the review period.

Representatives of the Defense Investigative Service (DIS) and the armed services provided the CFIUS staff chair a classified briefing on the nature of the contract. Promptly, CFIUS informed the parties to the transaction that it would be unable to clear the transaction until they concluded a satisfactory security arrangement. Subsequently, the parties withdrew their notice to the Committee. After several weeks of discussions with government security officials, they concluded a satisfactory arrangement. Soon after, the parties resubmitted the transaction to CFIUS, which approved the transaction. Again, while the case was not blocked or formally investigated, *CFIUS helped resolve a potential national security problem within the context of existing law and regulations.*

Case #3: Protecting Dual-Use Technology

A foreign buyer proposed buying a small instrument company. At issue was whether foreigners might gain access to technology which might have a dual use for military purposes with possible effects on U.S. national security. If so, CFIUS wished to determine whether the firm's internal control mechanisms were adequate to prevent unauthorized access to the technology.

Because the major issue involved technology, CFIUS asked for advice from the White House Office of Science and Technology Policy, scientists at the Departments of Defense and Energy, and the intelligence community to assess the military importance of the technology. CFIUS also examined the technology agreement between the seller and buyer to determine better the technology to which the buyer would have access. In addition, CFIUS examined internal company policies governing access to technology. CFIUS staff and interested members of CFIUS agencies met with the buyer and seller to receive answers to detailed, technical questions on these issues. After a thorough review, CFIUS concluded:

- o the technology was not readily applicable to military needs;
- o the buyer already possessed many aspects of the technology;
- o the technology could be exported under license from the Commerce Department;

- o the technology could not be obtained by reverse engineering or dismantling of the product; and
- o the company maintained a strict internal control program to prevent unauthorized access to technology.

With all issues satisfactorily resolved and confident that existing laws were adequate and appropriate to protect the national security, CFIUS cleared the transaction.

Case #4: Protecting Military Technology

A foreign customer of a U.S. software company sought to buy a division of the firm. The firm was in financial difficulty. The notice to CFIUS indicated its products could only be exported with a license under the Export Administration Act.

During the 30-day review, a civilian Defense Department scientist informed CFIUS that the underlying technical data of the software program was also subject to munitions controls under the Arms Export Control Act (AECA). Although the technical data could be licensed to the foreign buyer, CFIUS learned from government authorities administering munitions controls that the acquired firm had not applied for this license.

CFIUS informed the parties that it would not be able to clear the transaction until they corrected this problem. Soon after, the authorities who administer munitions controls informed CFIUS that the buyer had taken appropriate steps to conform with munitions controls. While this process was underway, CFIUS and government experts also examined the internal control procedures which the buyer would implement to protect against unauthorized access to the technology.

As no other issues were identified, and confident that existing laws were adequate and appropriate to protect the national security, CFIUS then cleared the transaction. Again, while the case was not blocked or formally investigated *CFIUS helped resolve a potential national security problem within the context of existing law and regulations.*

These cases give a few examples of the many ways CFIUS carries out its mandate to protect national security. As the examples have illustrated, the real impact of Exon-Florio is not captured by a simple tally of 540 notifications, 12 investigations, and 1 blocked transaction. The cases also illustrate how CFIUS carries out the intent of Exon-Florio carefully and thoroughly within the 30-day review period. When potential national security problems have arisen, existing laws and regulations have been adequate and appropriate to deal with those problems. In addition, there are instances when parties temporarily withdraw transactions so they can resolve national security problems without undertaking a formal 45-day investigation and report to the President, and without placing an undue burden on U.S. businesses.

Finally, the cases above illustrate how CFIUS identified national security problems and overcame them. Yet, there are other more subtle effects where the direct impact of CFIUS is harder to discern. For example, the legal and mergers and acquisitions communities are now aware that foreign acquisitions must pass CFIUS scrutiny. Lawyers and businessmen commonly call CFIUS staff for guidance in the early stages of a transaction. *Thus, CFIUS often helps assure transactions conform with national security laws and regulations before it receives an official notification.* The prospect of facing a CFIUS review has likely also deterred from taking place some transactions which CFIUS would not have approved. Unfortunately, the CFIUS review process may have also deterred some benign transactions which CFIUS would have approved. These are the costs and benefits of maintaining an open-ended process such as that mandated by the Exon-Florio provision.

JOBS

Concern: "the vast bulk [of recent foreign direct investment] has gone towards acquiring existing businesses, not creating new ones...Undoubtedly some of this investment may have saved jobs that would have been lost without it. But as a result of such rationalization, some of it also resulted in job reduction. This is in stark contrast to the mostly productive earlier waves of direct investment."[4]

Response: One cannot determine the employment effect of foreign investment by adding up jobs associated with foreign investment and subtracting the number of jobs lost because of the competition from foreign investment. This is a simplistic approach which has no basis in economics.

A particular foreign investment, as any other business operation, may affect employment in a specific town at a particular moment in time. Any long-run employment effects, however, are overwhelmed by macroeconomic policies, which are the primary determinants of overall U.S. employment levels.

Clearly, the immediate employment effects of a foreigner establishing a new firm are highly visible. Although it may be tempting to credit the foreign investment with "new jobs", the more enduring employment effect and benefit to our economy derive from the saving and investment process. These "employment effects" may be less visible in a merger, acquisition, or takeover than in the case of a foreigner establishing a new firm, but the real impact is generally the same.

When foreigners invest in the U.S. economy, they invest in American workers. They add capital, equipment, technology, and know-how. This makes American workers more productive, makes the United States more competitive internationally, increases wages, and raises our standard of living.

Investing in America's workers is critical in an international economy where developing countries can now produce most goods requiring only low-skill workers, while many of our industrialized competitors have matched or surpassed U.S. technological capabilities in some sectors. A highly-skilled work force with sophisticated equipment to help it is no longer a luxury. But maintaining and improving such a skilled and equipped work force requires massive and constant amounts of investment.

A high level of investment requires a high level of savings. Unfortunately, as the attached charts illustrate, U.S. savings have been declining at the same time our major competitors have been saving huge sums and investing in their work force. Foreign direct

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[4] Spencer, p. 6.

investment in the United States has been critical in filling this investment gap, thus allowing the United States to maintain higher investment rates and higher levels of employment and productivity, despite our declining saving rate.

PERFORMANCE REQUIREMENTS

Recommendation: "Foreign investors should be required to meet certain performance requirements -- i.e. keeping production and research and development in the United States -- if they wish to acquire a sensitive U.S. company."[5]

Response: The Administration opposes imposing mandatory performance requirements or receiving assurances for several reasons. Performance requirements burden the sectors on which they are imposed and inflict unfair conditions on foreign investors. Their disadvantages are overwhelming. They impose costs on investment with no compensation to investors; in so doing they discourage both foreign and domestic investment and harm the economy. They require detailed government intervention in the economy. They would discriminate against foreign investors, and would unfairly place U.S. firms acquired by foreigners at a competitive disadvantage.

Mandatory performance requirements are an unnecessary interference by the government on the domestic or foreign investor. Investors, both foreign and domestic, base decisions about what to produce, how to produce it, and where to produce it on market forces. They also follow their view of the market with regard to what research to undertake and where to undertake it. For the government to mandate to a foreign or domestic investor its preferred solutions would require the firm to shoulder all the risk of government decisions, with no accountability by the government to the owners of the firm.

Imposing such performance requirements raises several disturbing questions:

- o How should a firm respond to demands from the government to make a certain product in a U.S. facility if competing firms can earn a profit only by producing offshore? Which government agency would cover the difference between the firm's cost of production and the rate of return it requires to attract capital?

- o How should a firm respond to government demands that certain technologies be kept "alive" in the name of national security? For how long should the technology by kept alive? If the government insists that a certain technology be kept alive, how shall the government pay for that effort?

- o Who would decide when the technology becomes obsolete, and how the firm should respond when the market and technology change?

Requirements or assurances would create unnecessary red tape, expense, and serve to deter capital from the very sectors that are critical to our national security. To single out

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[5] Spencer, p. 3.

foreign investors for such treatment would intensify the problem. First, imposing requirements would deter foreigners' investments in these industries when the economy is becoming increasingly global and firms are establishing ties across all markets to stay competitive. This would hurt U.S. firms and U.S. workers that would benefit from the input of foreign capital, technology, and management skills.

Further, the ability of the government to mandate performance requirements would act as a hidden tax or disincentive to U.S. investors to invest in that industry. Both foreign and domestic investors are likely to put their money into countries and industries in which the government is not second guessing their decisions and looking over their shoulders, given the many alternative investment opportunities worldwide.

Performance requirements would raise costs, lower productivity and efficiency, and reduce the rate of return on capital by requiring firms to meet requirements that they otherwise would not if they were following their business interests. This would harm the competitiveness of these sectors and discourage both domestic and foreign investors from investing in these sectors.

Other countries have experimented with performance requirements and discovered that they are counterproductive. Moreover, they distort trade and investment flows. During Free Trade Agreement negotiations, Canada agreed to drop major performance requirements. And in bilateral investment treaty negotiations, the United States presses for an end to performance requirements.

As the recent World Bank Development Report noted, across the world, nations are moving away from the heavy hand of government interference in the market place, toward providing the most hospitable climate possible for foreign investment. It would be ironic and self-defeating if we adopt discriminatory measures such as performance requirements when the world is competing for foreign investment, and the United States is urging its major trading partners to reduce barriers to investment. The United States could lose investment in critical sectors and give other countries an excuse to impose their own requirements, hurting U.S. investors overseas.

TECHNOLOGY TARGETING

Concern: "Key U.S. industries such as semiconductor equipment, semiconductors, and advanced materials are continuing rapidly to fall under the control of foreign companies that are often part of their countries' industrial targeting programs."[6]

Response: If foreign investors are targeting U.S. high-technology firms, foreign direct investment should increase disproportionately in these sectors. However, according to Commerce Department data, the share of foreign direct investment inflows going to high-technology sectors did not change much during the 1980s - from 11.5% in 1980, to 9% in 1985, to 11.1% in 1988.

Moreover, U.S. technological competitiveness is improved when foreigners invest in high-technology industries. Foreign direct investment in the United States is not bleeding our technological base. Quite conversely, the United States obtains more technology than it contributes through foreign direct investment in the United States. This conclusion is based on payments of royalties and license fees, which generally reflect the value that companies place on their technology. Transfers to the United States through U.S. affiliates of foreign companies have been more than five times larger than technology transfers out by them during the 1980-89 period - $7.8 billion compared to $1.4 billion.

By joint operations with foreign companies, U.S. high-technology companies benefit in other important ways including access to:

- capital saving companies that might otherwise have gone out of business - a situation that CFIUS sees with some frequency;
- foreign research and development, and increased research and development funding;
- global marketing and distribution networks;
- foreign manufacturing capabilities that help U.S. firms achieve economies of scale.

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[6] Spencer, p. 3.

FREE-RIDING OFF GOVERNMENT SUBSIDIZED RESEARCH

Concern: "[C]ertain acquisitions could give foreign firms the benefits of technologies developed with U.S. taxpayers' money for the express purpose of enhancing the economic competitiveness of U.S. firms...Foreign investors that benefit from U.S. financed research are not expected to compensate U.S. taxpayers for the future sale of products developed with their funds."[7]

Response: This concern has essentially two parts:

1) Foreigners are obtaining technology developed with taxpayers' assistance; and

2) Foreign firms are getting a free ride by not compensating U.S. taxpayers for this technology.

OBTAINING THE TECHNOLOGY

Our export control laws restrict the transfer of technologies and know-how, whether or not they were developed with U.S. Government funds. If foreigners buy a U.S. firm that has technology subject to these laws, these laws cover their access to such technology. However, our export control laws only restrict the transfer of technologies which could threaten our national security or harm our foreign policy interests. It makes little sense to try to deter foreigners from gaining technology through investment which they can legally get through trade or licensing agreements.

PAYING A FAIR PRICE FOR GOVERNMENT SUBSIDIZED RESEARCH

The pricing of technology is no different from the pricing of other goods and services. When U.S. firms develop technology with U.S. Government assistance, they sometimes sell goods using that technology or license the technology, and recover the costs of developing the technology over time. U.S. taxpayers are "paid back" from taxes on the profits of these sales or licensing agreements. Other domestic and foreign firms benefit from "learning" or "spillover" effects.

In an acquisition, the cost of the technology, along with the other assets and intellectual property of a firm, is paid for up front. U.S. taxpayers are "paid back" from taxes on the profits of the sale of the firm.

In deciding how much to pay for an asset, businessmen use discounted cash-flow analyses to equate the value of a future stream of payments with lump sum payments.

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[7] Spencer, p. 4, 15.

Whether a U.S. firm receives a stream of future payments or gets paid up front, the economic benefit is the same.

Finally, restricting investment in high-tech firms which receive government assistance could be counterproductive. It would not only reduce foreign infusions of capital but would also discourage U.S. investors from providing funds since they would be restricted from selling their stake to the highest bidders. The government would end up starving the exact sectors it is trying to promote. The United States would not be better off if a U.S. firm that had received government assistance either goes bankrupt or fails to bring a product to market due to a lack of capital.

As Assistant Secretary of Commerce for Technology Policy Deborah Wince-Smith recently stated before the House Science, Space and Technology Committee,

> "Rather than reducing the flexibility and freedom our firms have in forming business and financial alliances, the real issue we must address is creating an economic and cultural environment in the United States that is conducive to long-term investment in innovation and the rapid commercialization of new technology."

The President has proposed a range of proposals to boost our technological competitiveness. These include decreasing government dissaving by adhering to the budget agreement, increasing R&D funding, making the research and experimentation (R&E) tax credit permanent, cutting the capital gains tax, improving our financial system, and removing regulatory impediments. This is what is ultimately needed to improve our technological competitiveness, not withholding foreign capital and know-how.

OTHER ISSUES

MAJORITY OWNERSHIP

Concern: "CFIUS has adopted a policy of non-review where the investment is less than 50 percent ownership."[8]

Response: This is incorrect. There is no percentage threshold which exempts transactions from review or results in automatic approval. Case #2 was an example of a case CFIUS commonly reviews in which the foreign buyer is purchasing less than 50% of the U.S. firm.

The key issue for CFIUS is whether or not the foreigner will have control over the U.S. entity. The proposed regulations state, "the test for control focuses on the power, whether or not exercised, to formulate, determine, direct, or decide important matters relating to the entity."[9] The Exon-Florio amendment applies only to foreign acquisitions in which the foreigner gets control of the U.S. entity. There is no percentage threshold under which all transactions are approved. There has been no change in policy.

COMMERCE & DEFENSE REQUESTS FOR INVESTIGATIONS

Concern: "Only 12 [cases] were formally investigated [by CFIUS] (all at the behest of either the Commerce or Defense Department)."[10]

Response: This is incorrect. Requests for investigations have come from many different CFIUS participants.

As an informal rule, CFIUS will move to a formal 45-day investigation if three or more Presidential appointees from CFIUS agencies request one. However, the executive order implementing Exon-Florio states,

> "[i]f one or more Committee members differ with a Committee decision not to undertake an investigation the Chairman shall submit a report of the Committee to the President setting forth the differing views and presenting the issues for his decisions within 25 days after receipt by the Committee of written notification of the proposed or pending merger, acquisition, or takeover."[11]

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[8] Spencer, p. 13.

[9] 54 Fed. Reg. 29,747 (July 14, 1989) (section 800.213).

[10] Spencer, p. 9.

[11] Exec. Order No. 12661, 54 Fed. Reg. 781 (1989).

No agency has been denied a request for investigation under this informal rule of three. In addition, no agency has found it necessary to invoke the provision of the executive order.

GOVERNMENT BAILOUT OF U.S. FIRMS

Recommendation: "When U.S. companies do reach a crisis state, the U.S. Government should work with American business to secure a U.S. buyer."[12]

Response: We disagree. The U.S. Government should not serve the role of an investment banker. Providing an implicit government commitment to help firms that are in trouble removes the incentive to manage a firm well. The "heads I win, tails the government loses" mentality demonstrated by some in the savings and loan industry clearly illustrates the danger of providing such government guarantees. Moreover, civil servants do not have the expertise to do better than professional investment bankers in finding a buyer.

MISSING CRITICAL TRANSACTIONS

Concern: "[CFIUS'] major shortcoming is the lack of ability to gain knowledge of investments because parties involved in a foreign acquisition are not required to notify CFIUS."[13]

Response: While CFIUS employs a voluntary system of notification, firms have a strong incentive to notify CFIUS. Under Exon-Florio, if CFIUS does not review a transaction, the President may order divestment at any time in the future. This would be time consuming and expensive. Moreover, the legal community is acutely aware that the President has the authority to divest transactions which CFIUS has not reviewed and attorneys therefore usually advise their clients to file a notification if there is any question that a takeover may have national security implications.

We are confident that CFIUS reviews the critical cases. In fact, no one has identified a case which might have threatened our national security which CFIUS missed. Any requirement for mandatory filings would result in CFIUS' reviewing many transactions which do not threaten our national security. This would increase the need for resources for no real gain.

IMPROVING THE BUSINESS CLIMATE

Concern: "Washington should pay more attention to improving the business climate in

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[12] Spencer, p. 17.

[13] Spencer, p. 10.

which these [high-technology] firms operate -- by lowering the cost of capital..."[14]

Response: As stated earlier, the Administration is committed to a program which will lower the cost of capital and thus help improve the business climate. However, the prescriptions promoted in the Economic Strategy Institute's report will reduce the supply of foreign capital, increase the riskiness of the investment environment, and thus increase the cost of capital.

[14] Spencer, p. 17.

TREASURY NEWS

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DEPT. OF THE TREASURY

FOR RELEASE WHEN AUTHORIZED AT PRESS CONFERENCE
July 31, 1991

CONTACT: Office of Financing
202/376-4350

TREASURY AUGUST QUARTERLY FINANCING

The Treasury will raise about $16,375 million of new cash and refund $21,637 million of securities maturing August 15, 1991, by issuing $14,000 million of 3-year notes, $12,000 million of 10-year notes, and $12,000 million of 30-year bonds. The $21,637 million of maturing securities are those held by the public, including $1,431 million held, as of today, by Federal Reserve Banks as agents for foreign and international monetary authorities.

The three issues totaling $38,000 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, Federal Reserve Banks hold $2,443 million of the maturing securities for their own accounts, which may be refunded by issuing additional amounts of the new securities at the average prices of accepted competitive tenders.

The 10-year note and 30-year bond being offered today will be eligible for the STRIPS program.

<u>If, under Treasury's usual operating procedures, the auction of 10-year notes results in the same interest rate as on the outstanding 8% bonds of August 15, 2001, the new notes will be issued with either a 7-7/8% or an 8-1/8% coupon. The 8-1/8% coupon rate will apply if the auction results in a yield in a range of 8.07% through 8.24%.</u>

Details about each of the new securities are given in the attached highlights of the offering and in the official offering circulars.

oOo

Attachment

NB-1405

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC
AUGUST 1991 QUARTERLY FINANCING

July 31, 1991

Amount Offered to the Public	$14,000 million	$12,000 million	$12,000 million
<u>Description of Security</u>:			
Term and type of security	3-year notes	10-year notes	30-year bonds
Series and CUSIP designation	Series T-1994 (CUSIP No. 912827 B8 4)	Series C-2001 (CUSIP No. 912827 B9 2)	Bonds of August 2021 (CUSIP No. 912810 EK 0)
CUSIP Nos. for STRIPS Components . .	Not applicable	Listed in Attachment A of offering circular	Listed in Attachment A of offering circular
Issue date	August 15, 1991	August 15, 1991	August 15, 1991
Maturity date	August 15, 1994	August 15, 2001	August 15, 2021
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
<u>Terms of Sale</u>:			
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
<u>Payment Terms</u>:			
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
<u>Key Dates</u>:			
Receipt of tenders	Tuesday, August 6, 1991	Wednesday, August 7, 1991	Thursday, August 8, 1991
a) noncompetitive	prior to 12:00 noon, EDST	prior to 12:00 noon, EDST	prior to 12:00 noon, EDST
b) competitive	prior to 1:00 p.m., EDST	prior to 1:00 p.m., EDST	prior to 1:00 p.m., EDST
Settlement (final payment due from institutions):			
a) funds immediately available to the Treasury	Thursday, August 15, 1991	Thursday, August 15, 1991	Thursday, August 15, 1991
b) readily-collectible check	Tuesday, August 13, 1991	Tuesday, August 13, 1991	Tuesday, August 13, 1991

TALKING POINTS
FOR THE
FINANCING PRESS CONFERENCE
July 31, 1991

Today we are announcing the terms of our regular August quarterly refunding. I will also discuss the Treasury's financing requirements for the balance of the current calendar quarter and our estimated cash needs for the October-December 1991 quarter.

1. We are offering $38.0 billion of notes and bonds to refund $21.6 billion of privately-held notes maturing on August 15 and to raise approximately $16.4 billion of cash. The three securities are:

--First, a 3-year note in the amount of $14.0 billion, maturing on August 15, 1994. This note is scheduled to be auctioned on a yield basis on Tuesday, August 6. The minimum denomination will be $5,000. Purchases may be made in any higher multiples of $5,000.

--Second, a 10-year note in the amount of $12.0 billion, maturing on August 15, 2001. This note is scheduled to be auctioned on a yield basis on Wednesday, August 7. The minimum denomination will be $1,000.

--Third, a 30-year bond in the amount of $12.0 billion, maturing August 15, 2021. This bond is scheduled to be auctioned on a yield basis on Thursday, August 8. The minimum denomination will be $1,000.

2. We will accept noncompetitive tenders up to $1,000,000 for each of the note and bond auctions.

3. If, under Treasury's usual operating procedures, the auction of 10-year notes results in the same interest rate as on the outstanding 8% bonds of August 15, 2001, the new notes will be issued with either a 7-7/8% or an 8-1/8% coupon. The 8-1/8% coupon rate will apply if the auction results in an average yield in a range of 8.07% to 8.24%.

4. For the current July-September quarter, we estimate a net market borrowing need of $107.7 billion. The estimate assumes a $30 billion cash balance at the end of September. We may want to have a higher balance, depending upon our assessment of cash needs at the time.

Including this refunding we will have raised $63.1 billion of the $107.7 billion in net market borrowing needed this July-September quarter. This net borrowing was accomplished as follows:

-- $4.2 billion of cash from the 7-year note that settled July 15;

-- $8.1 billion of cash from the 2-year notes which settled July 1 and July 31;

-- $11.5 billion of cash from the 5-year notes which settled July 1 and July 31;

-- $18.9 billion of cash from the sale of the regular weekly bills, including the bills announced yesterday;

-- $4.0 billion of cash in 52-week bills;

-- $16.4 billion of cash from the refunding issues announced today.

The $44.6 billion to be raised in the rest of the July-September quarter could be accomplished through sales of regular 13-, 26-, and 52-week bills, and 2-year and 5-year notes at the end of August and September. We may sell cash management bills to cover low cash balances in the quarter.

5. We estimate Treasury net market borrowing needs to be in the range of $85 to $90 billion for the October-December 1991 quarter, assuming a $30 billion cash balance on December 31.

6. The 10-year notes and 30-year bonds being announced today are eligible for conversion to STRIPS (Separate Trading of Registered Interest and Principal of Securities) and, accordingly, may be divided into separate interest and principal components.

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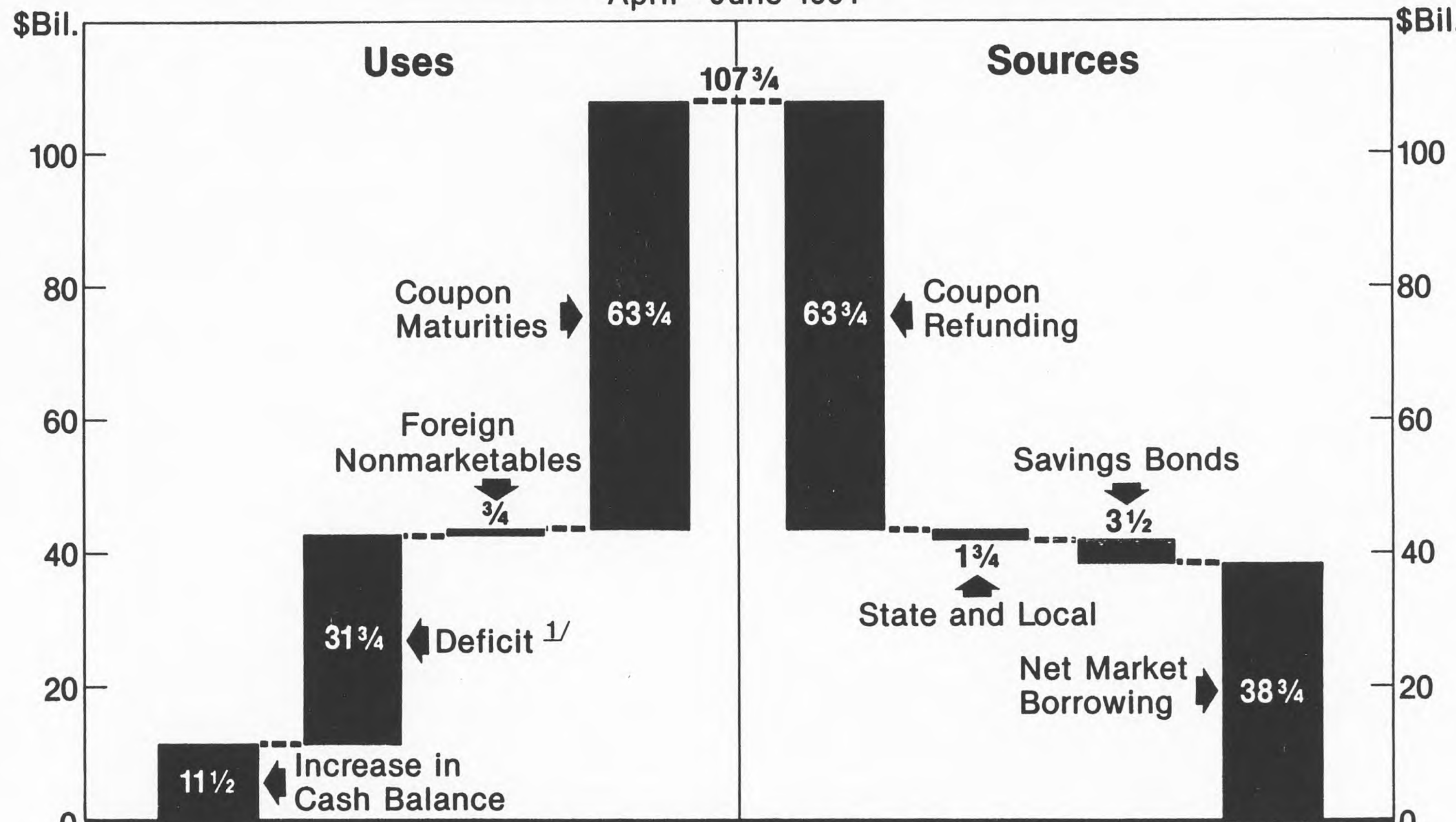
TREASURY FINANCING REQUIREMENTS

April - June 1991



1/ Includes budget deficit, changes in accrued interest and checks outstanding and minor miscellaneous debt transactions.

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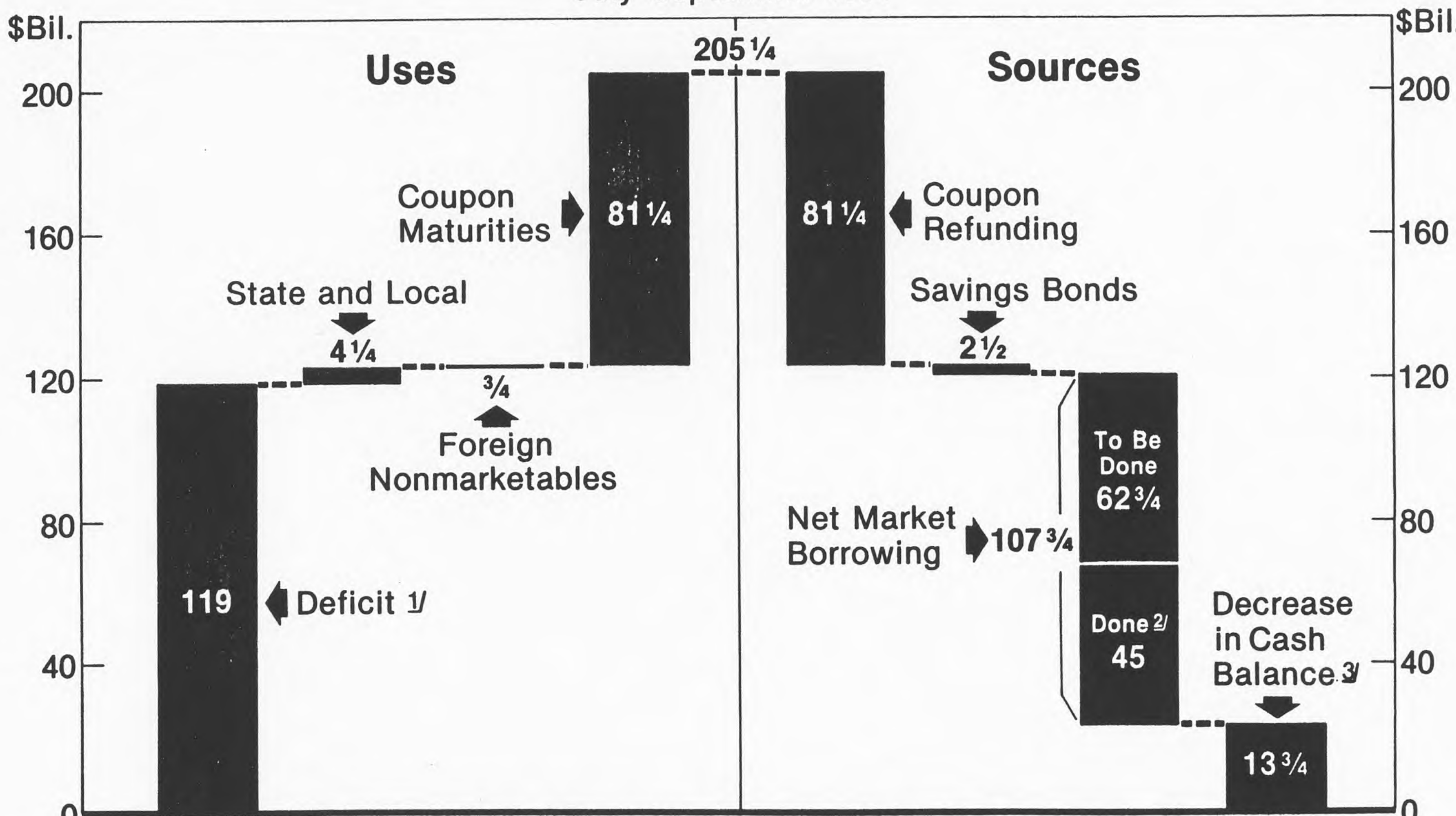
Office of Market Finance

July 30, 1991-24

TREASURY FINANCING REQUIREMENTS

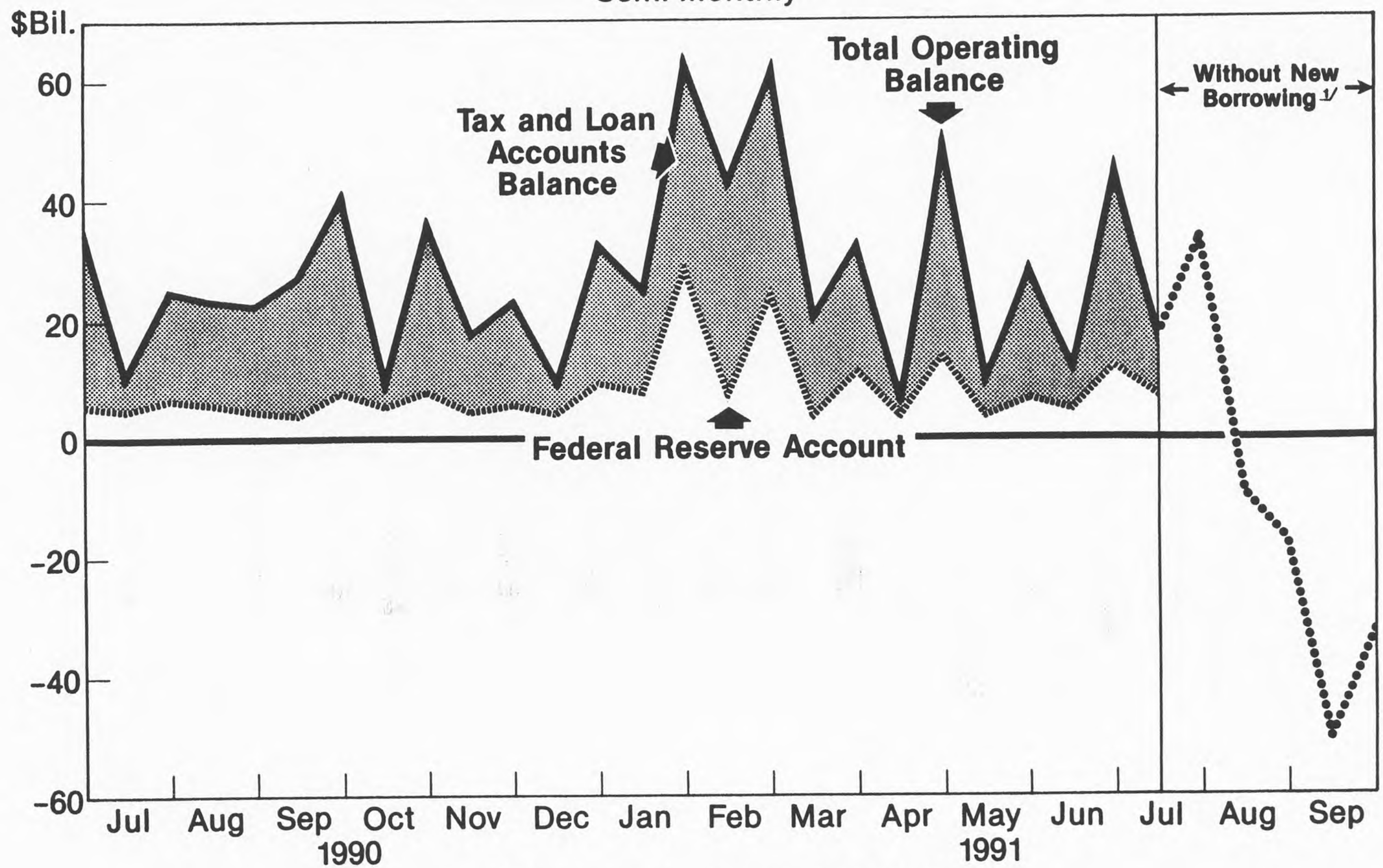
July-September 1991



1/ Includes budget deficit, changes in accured interest and checks outstanding and minor miscellaneous debt transactions.
2/ Issued or announced through July 26, 1991.
3/ Assumes a $30 billion cash balance September 30, 1991.

TREASURY OPERATING CASH BALANCE

Semi-Monthly



1/ Assumes refunding of maturing issues.

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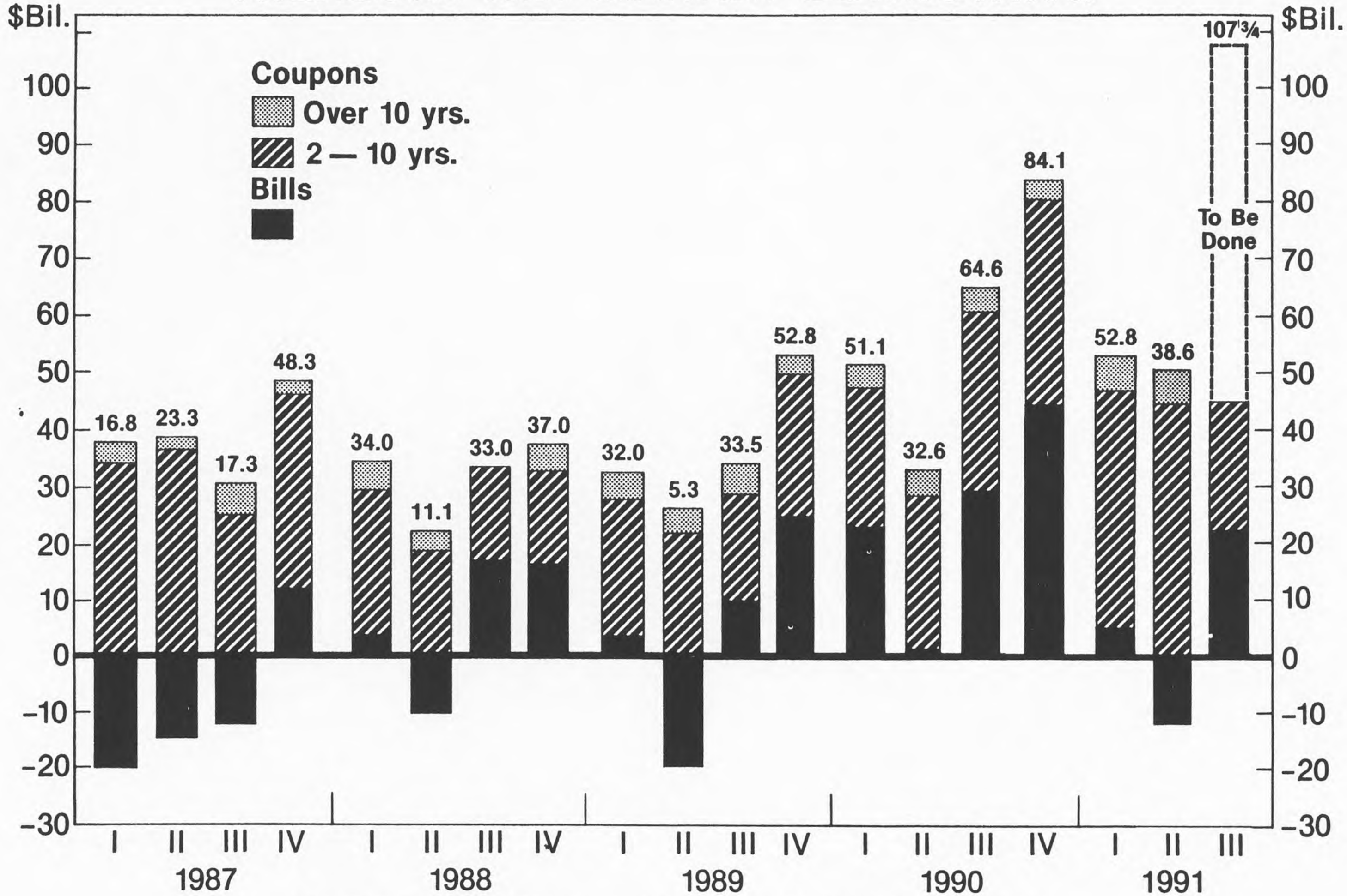
July 30, 1991-15

TREASURY NET MARKET BORROWING[1/]



1/Excludes Federal Reserve and Government Account Transactions.

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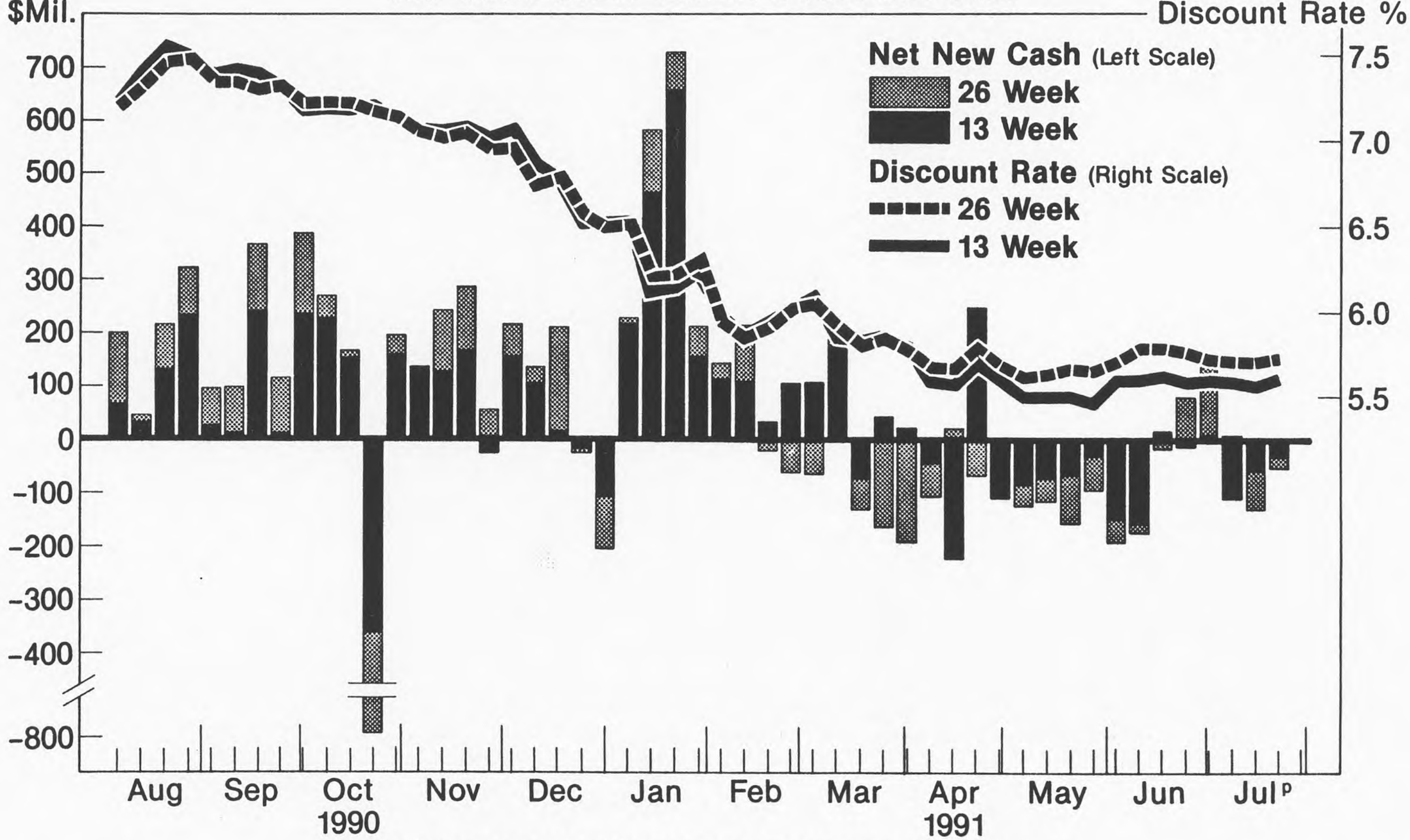
July 30, 1991-5

NET NEW CASH FROM NONCOMPETITIVE TENDERS IN WEEKLY BILL AUCTIONS 1/



1/ Excludes noncompetitive tenders from foreign official accounts.
p Preliminary

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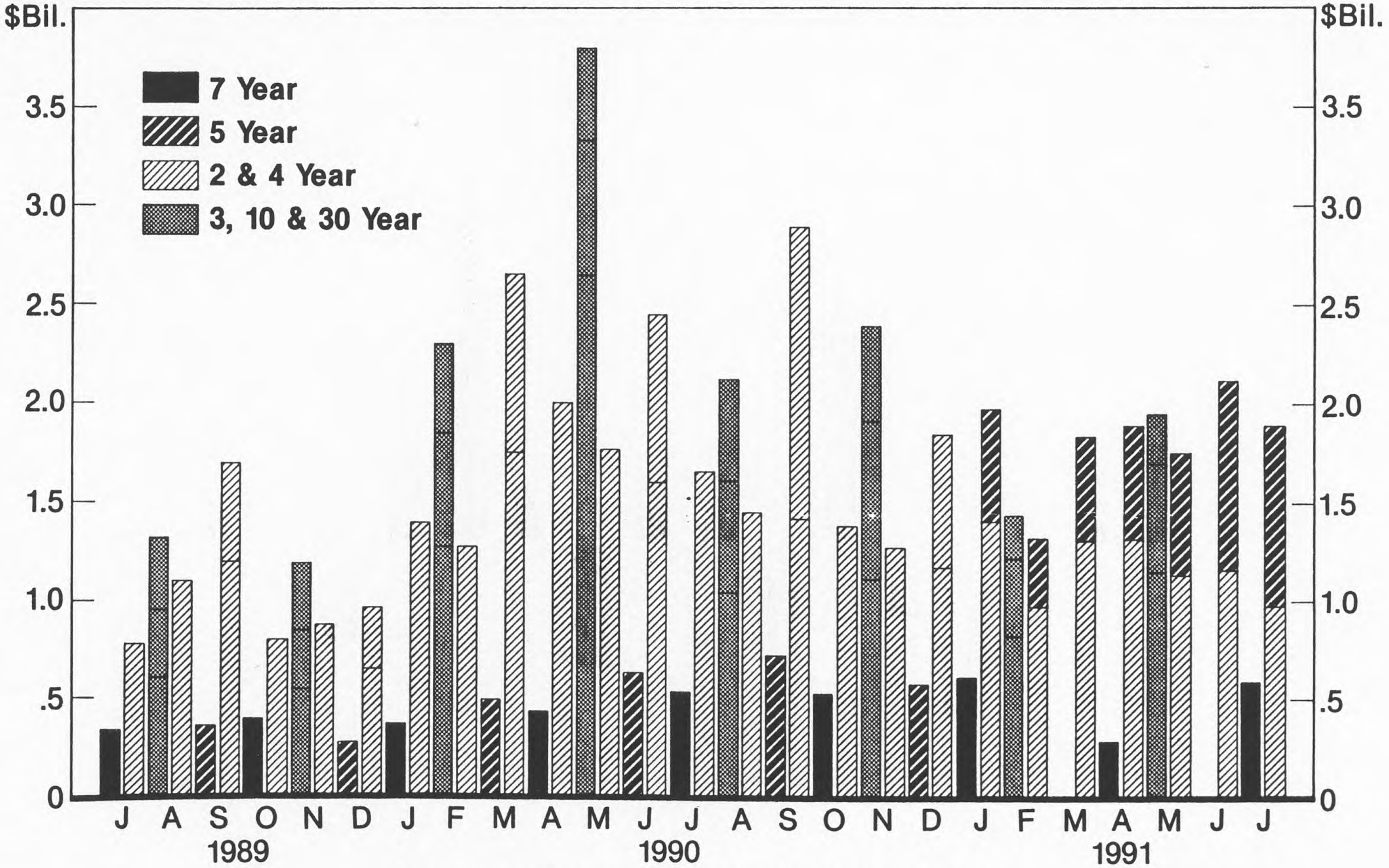
July 30, 1991-25

NONCOMPETITIVE TENDERS IN TREASURY NOTES AND BONDS 1/



1/ Excludes foreign add-ons from noncompetitive tenders.

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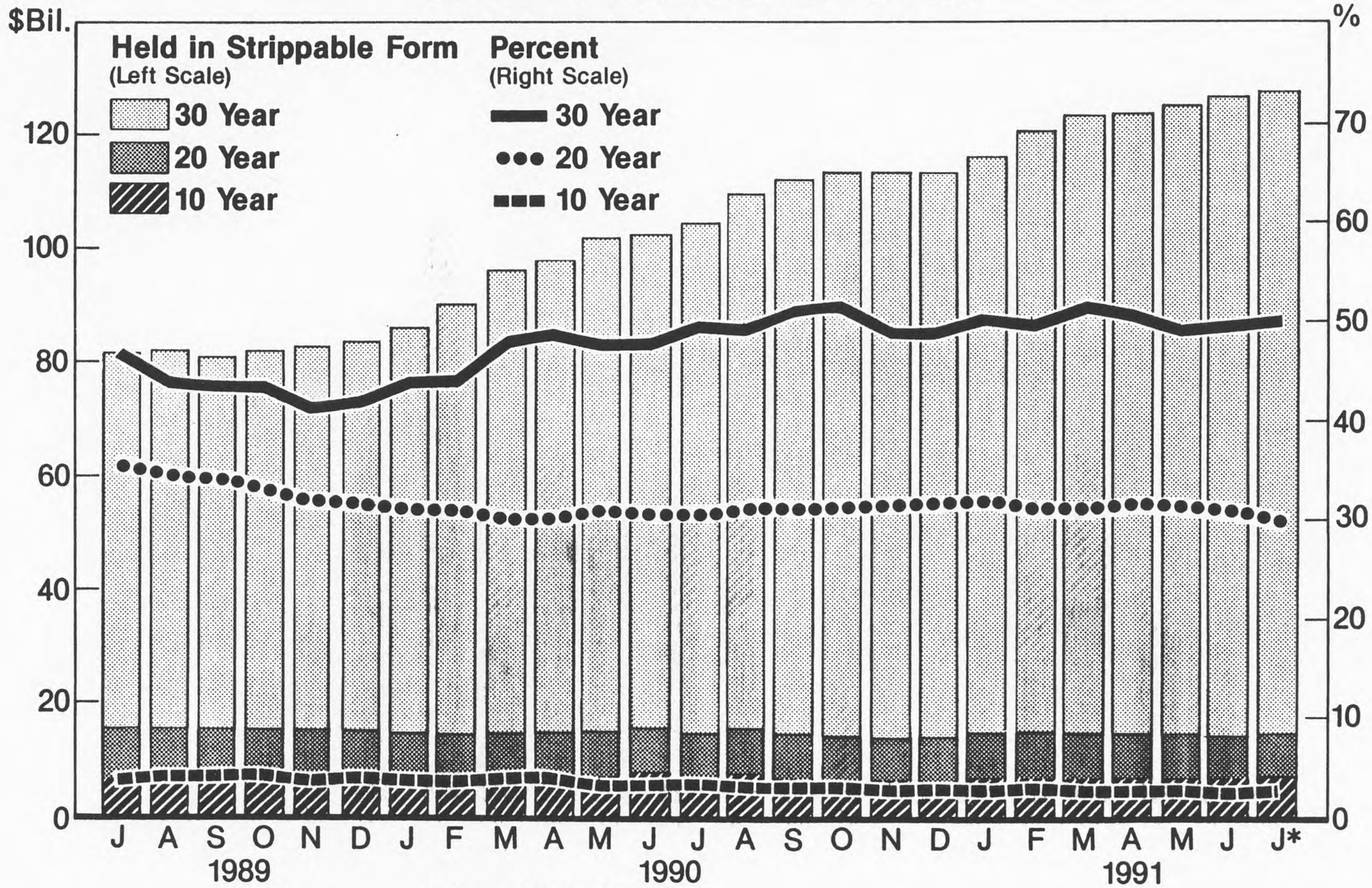
July 30, 1991-22

NET STRIPS AS A PERCENT OF PRIVATELY HELD STRIPPABLE SECURITIES



*Through July 19, 1991
Note: Reconstitution began May 1, 1987

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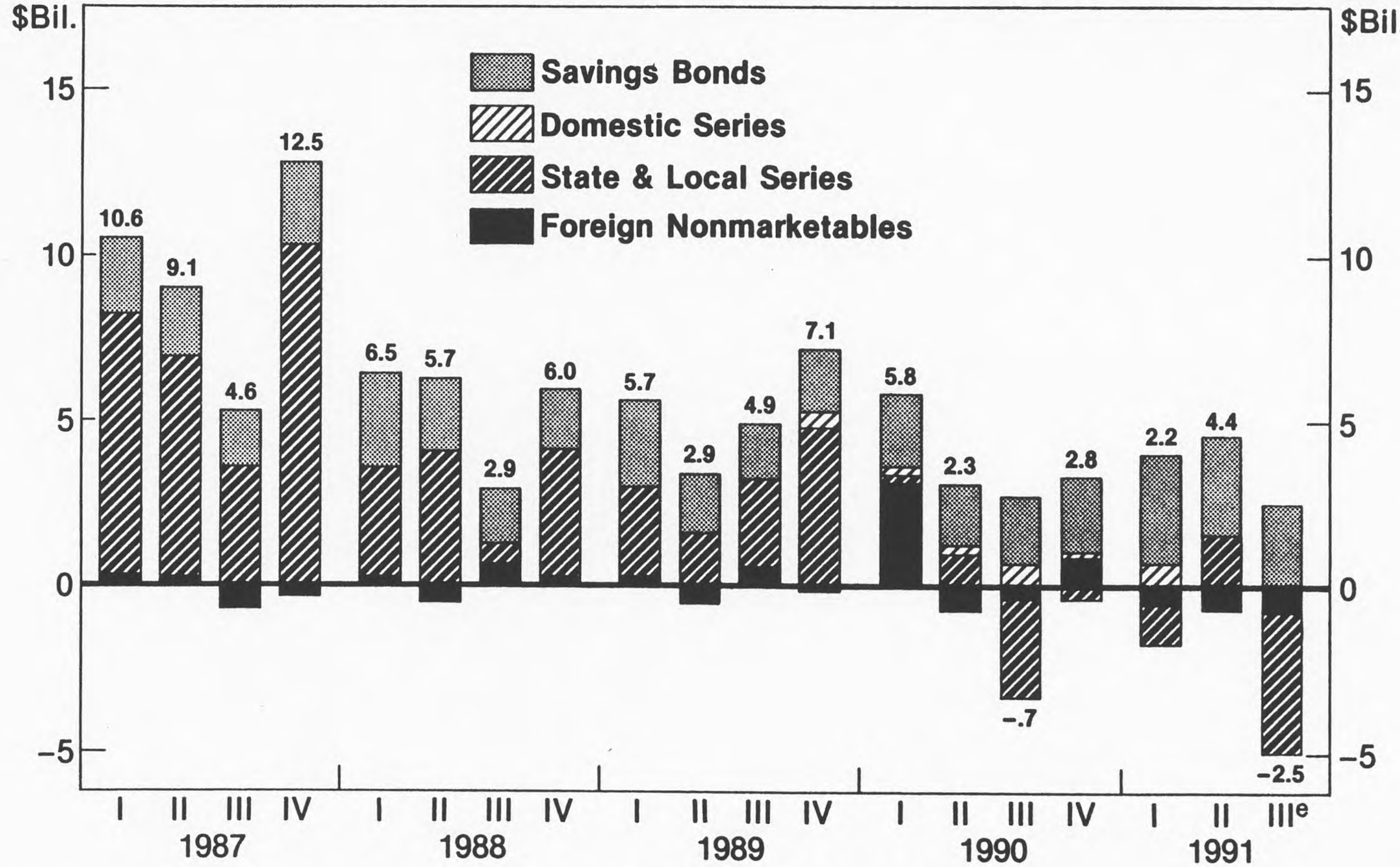
July 30, 1991-19

TREASURY NET BORROWING FROM NONMARKETABLE ISSUES



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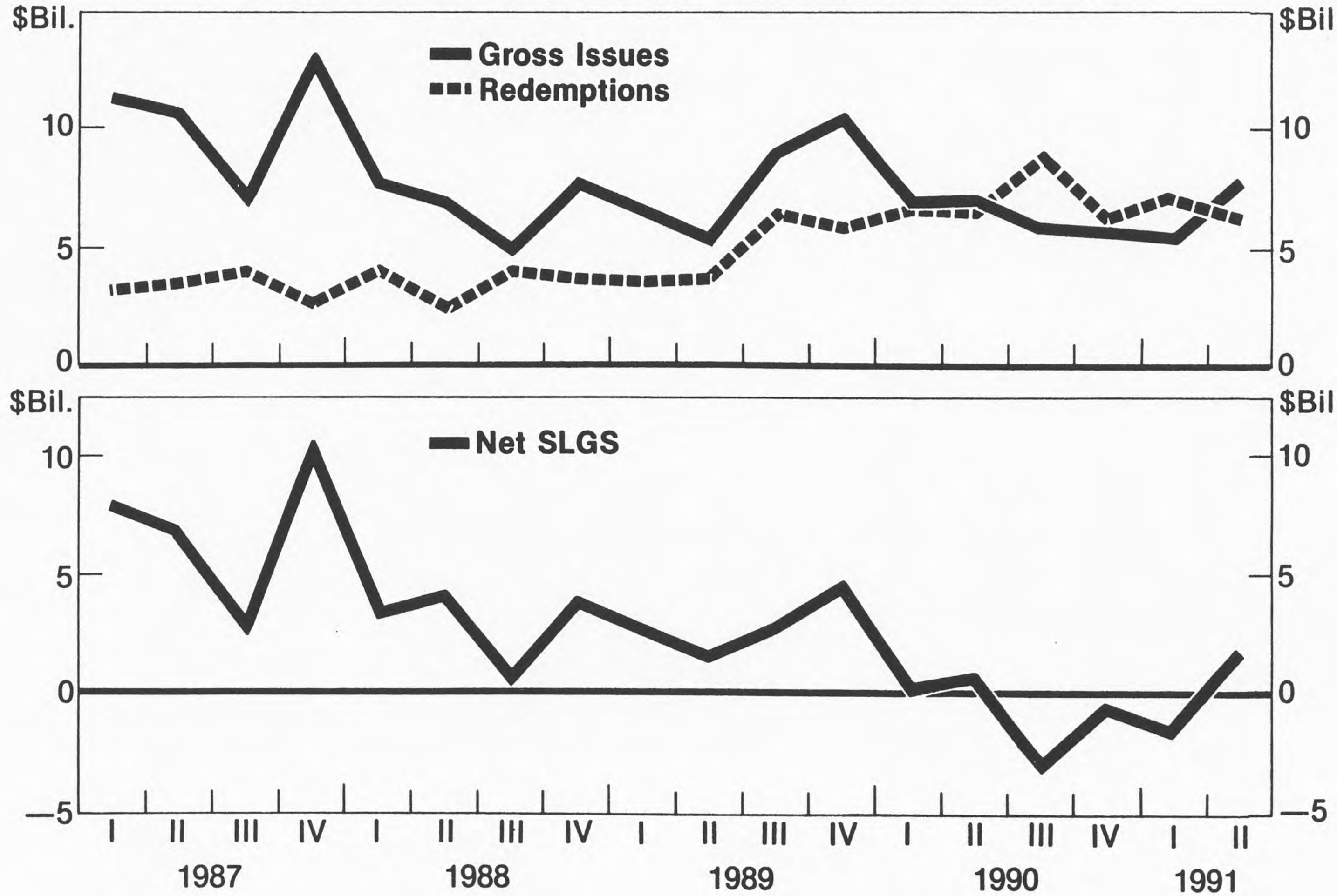
STATE & LOCAL GOVERNMENT SERIES



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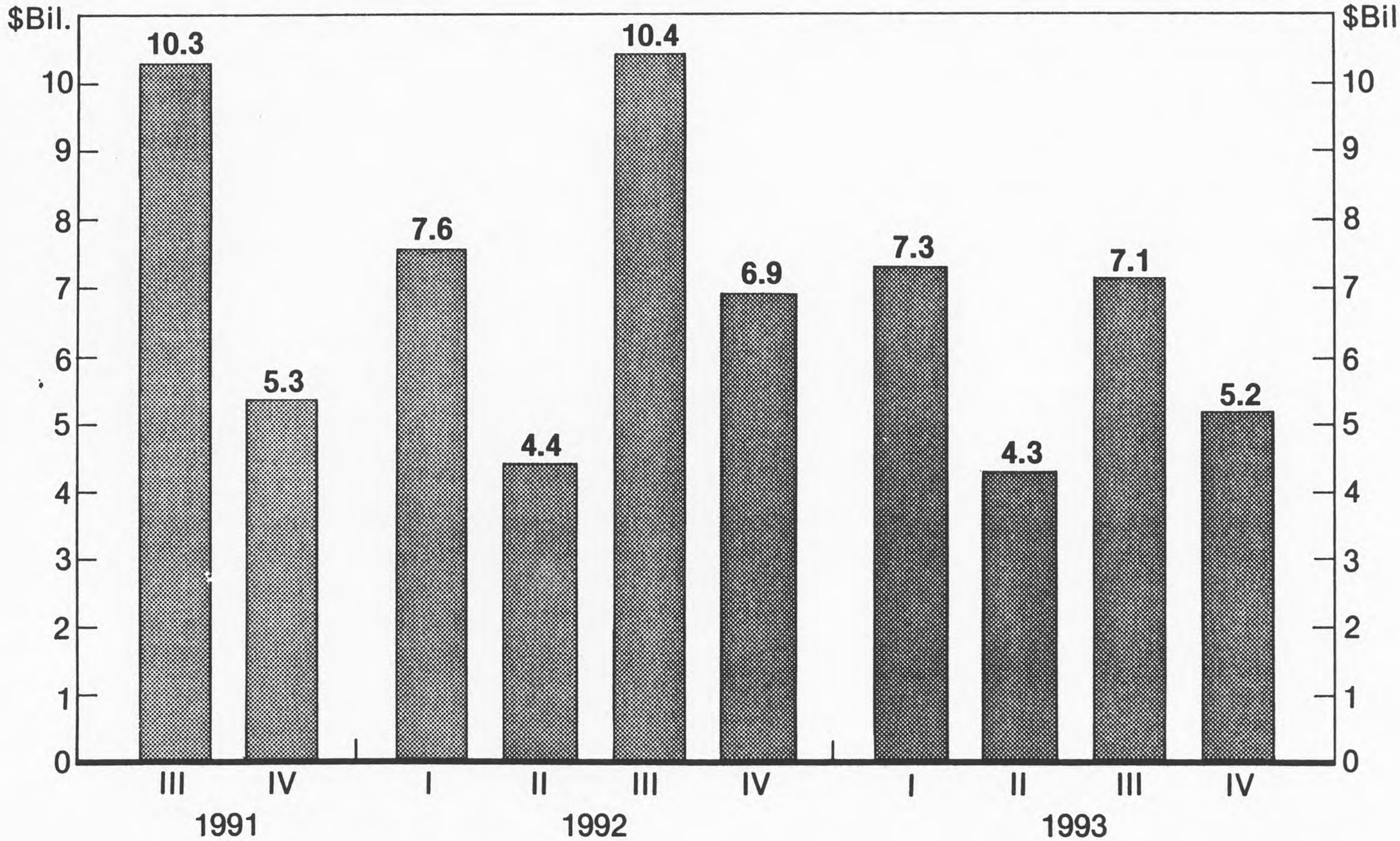
July 30, 1991-7

STATE AND LOCAL MATURITIES 1991 — 1993



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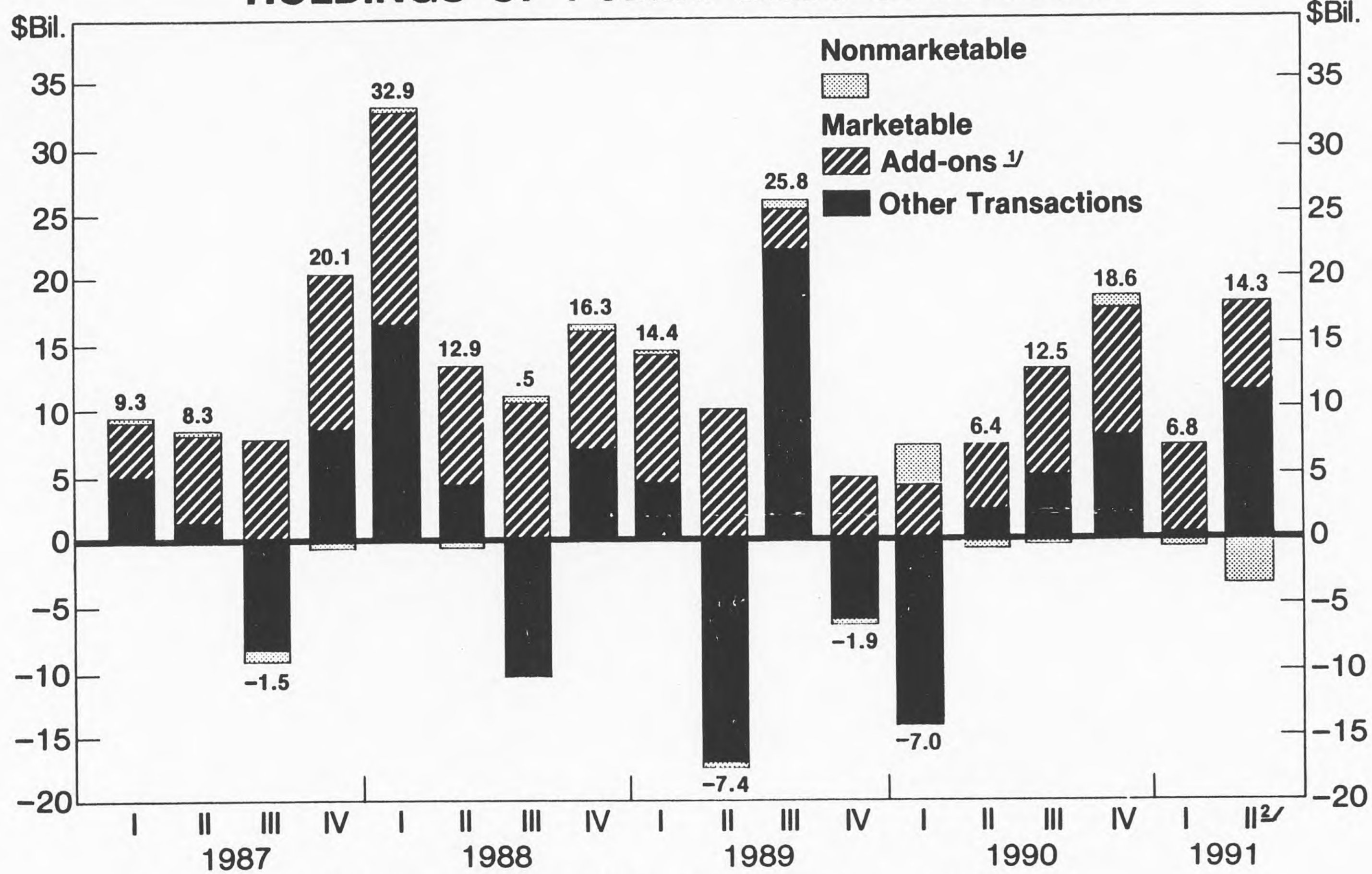
July 30, 1991-6

QUARTERLY CHANGES IN FOREIGN AND INTERNATIONAL HOLDINGS OF PUBLIC DEBT SECURITIES



1/ F.R.B. purchases of marketable issues as agents for foreign and international monetary authorities which are added to the announced amount of the issue.
2/ Preliminary.

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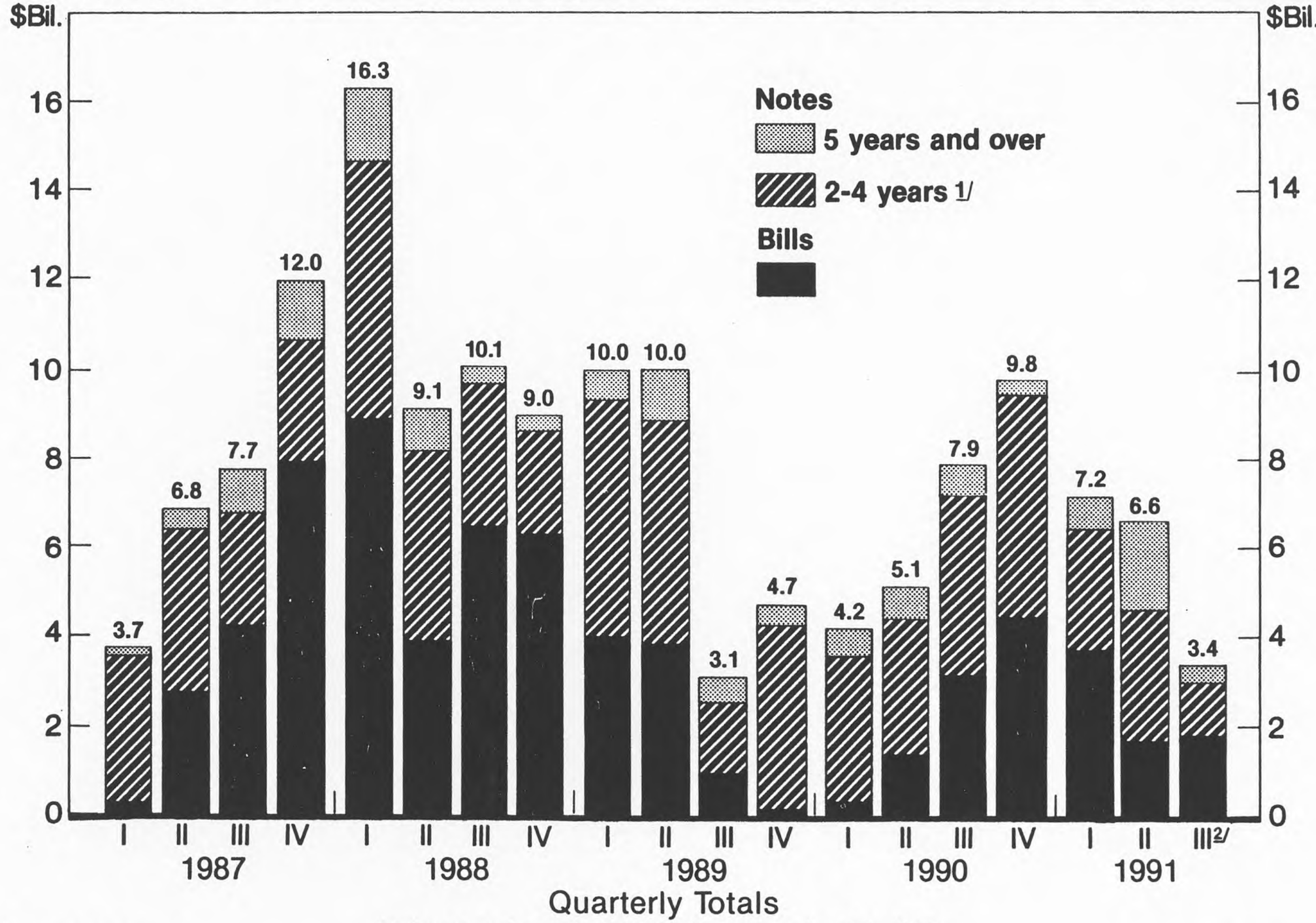
July 30, 1991-18

FOREIGN ADD-ONS IN TREASURY BILL AND NOTE AUCTIONS



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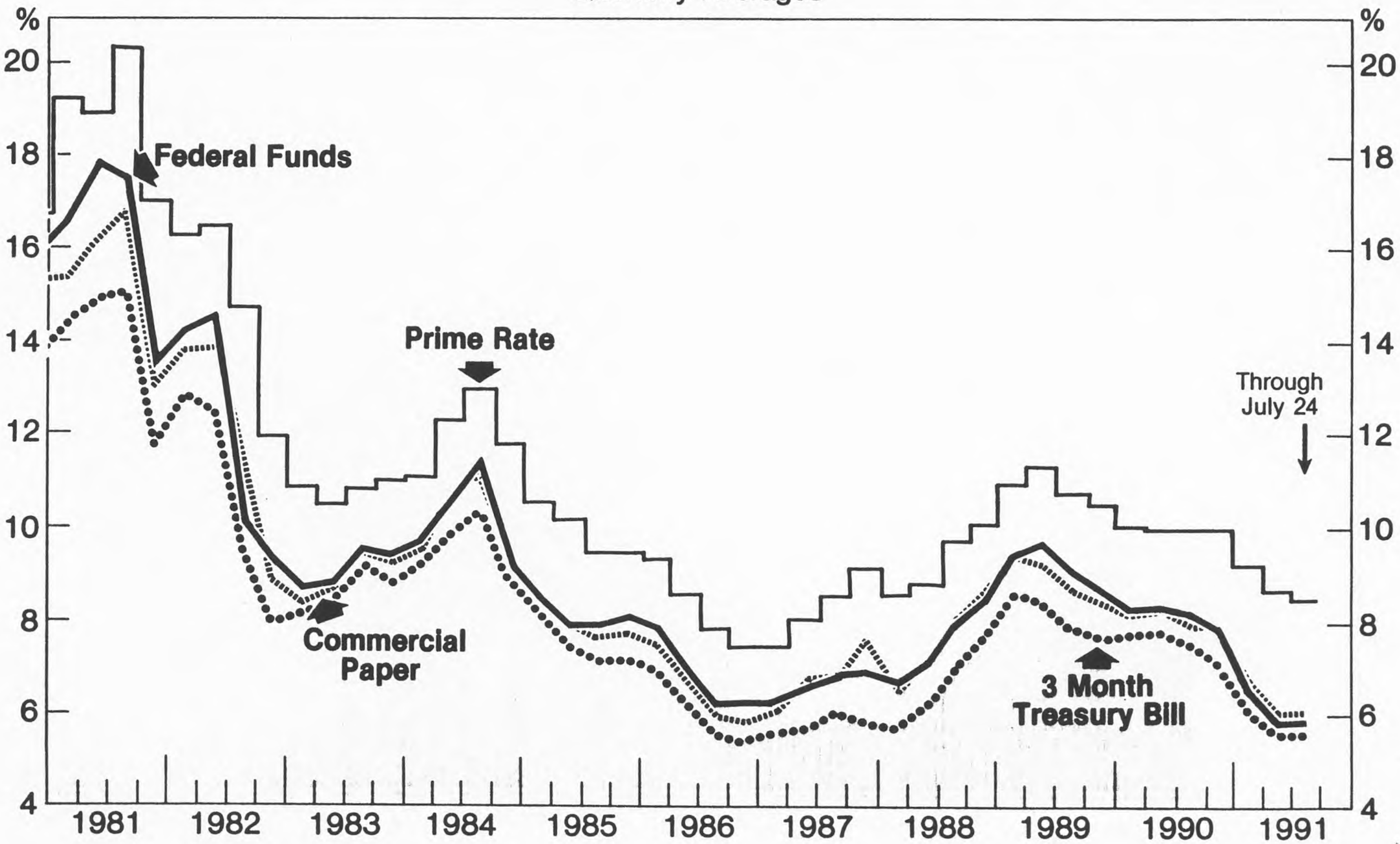
1/ 4 year notes not issued after December 31, 1990.
2/ Through July 26, 1991.

July 30, 1991-4

SHORT TERM INTEREST RATES

Quarterly Averages



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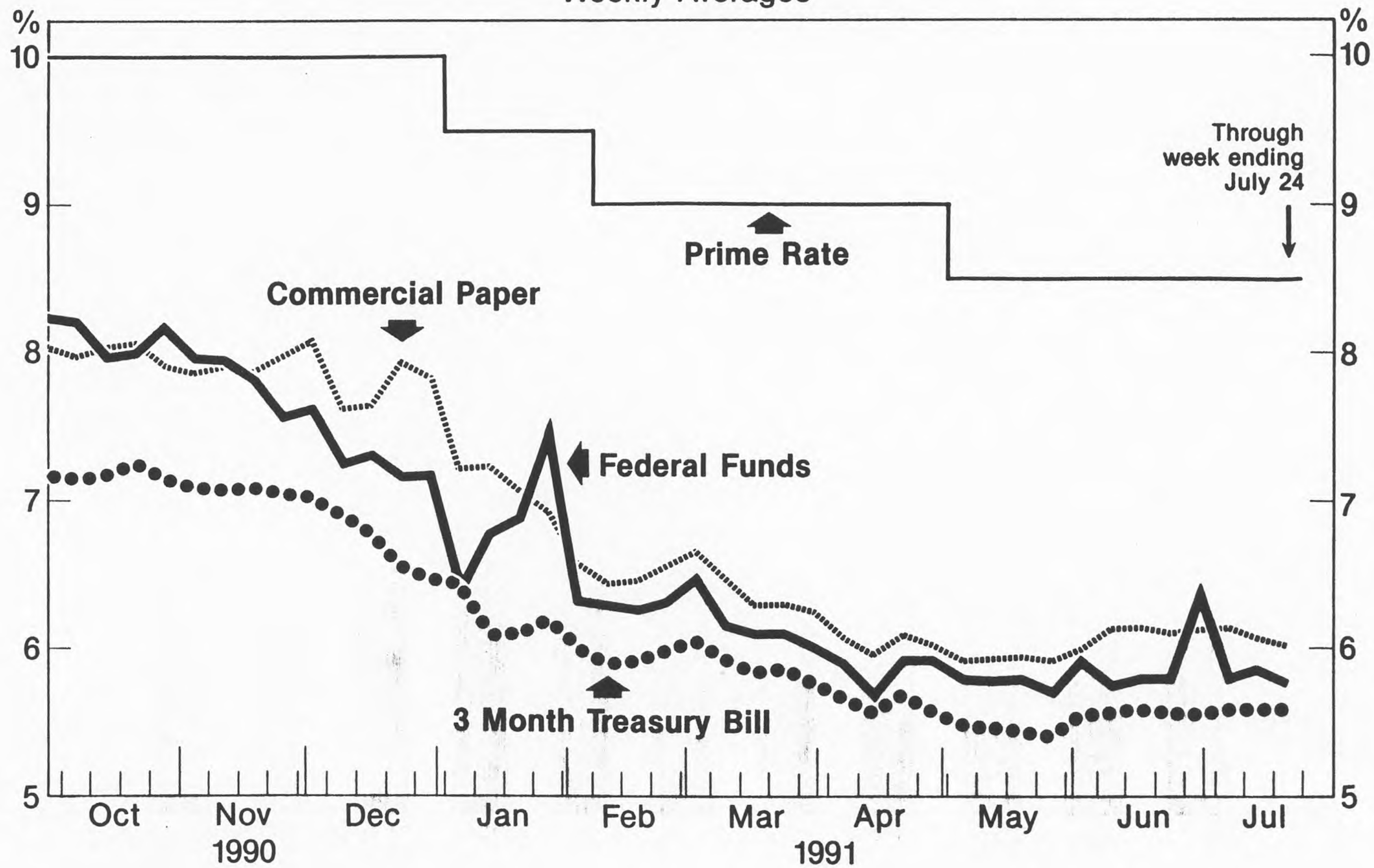
July 30, 1991-9

SHORT TERM INTEREST RATES

Weekly Averages



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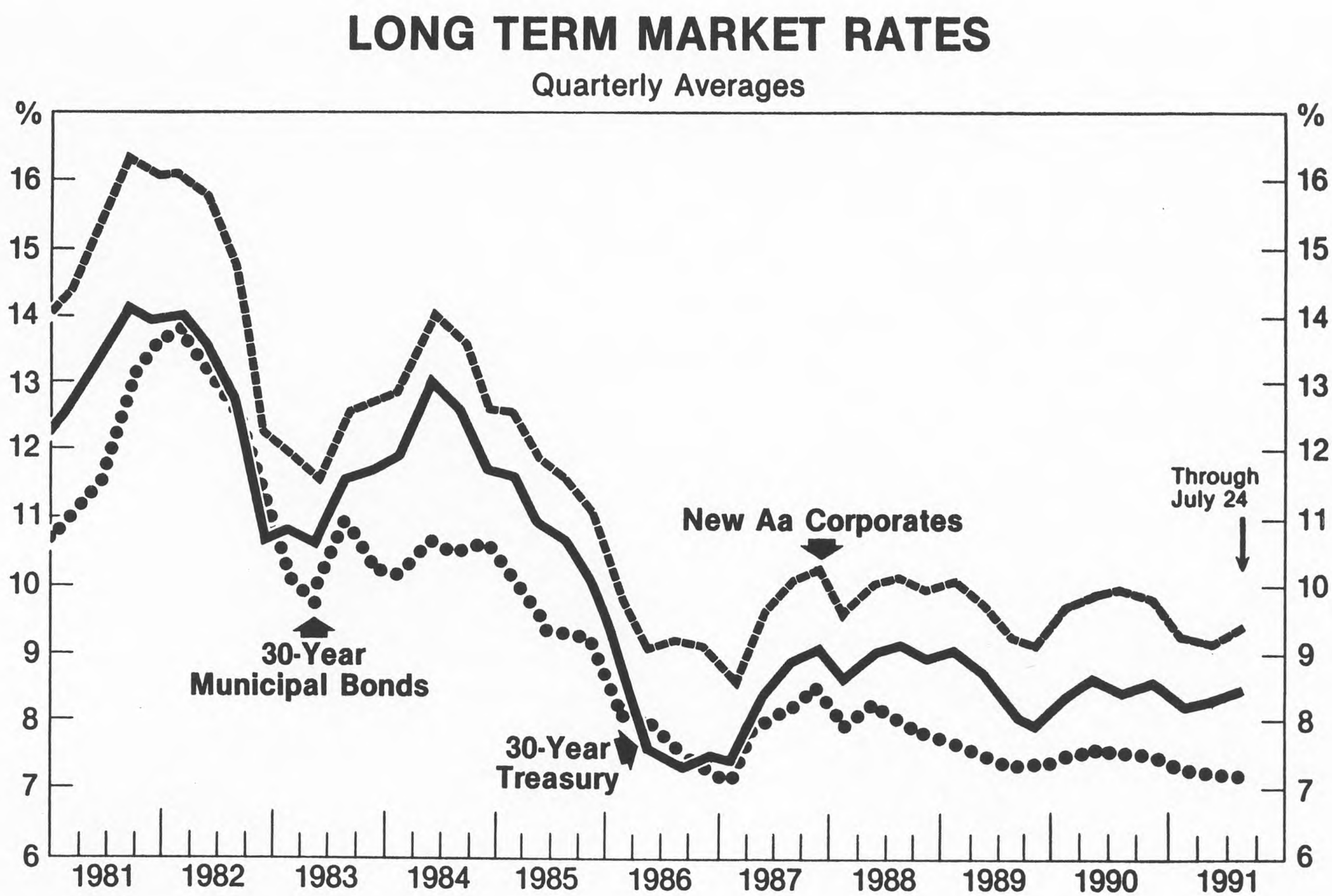
July 30, 1991-8



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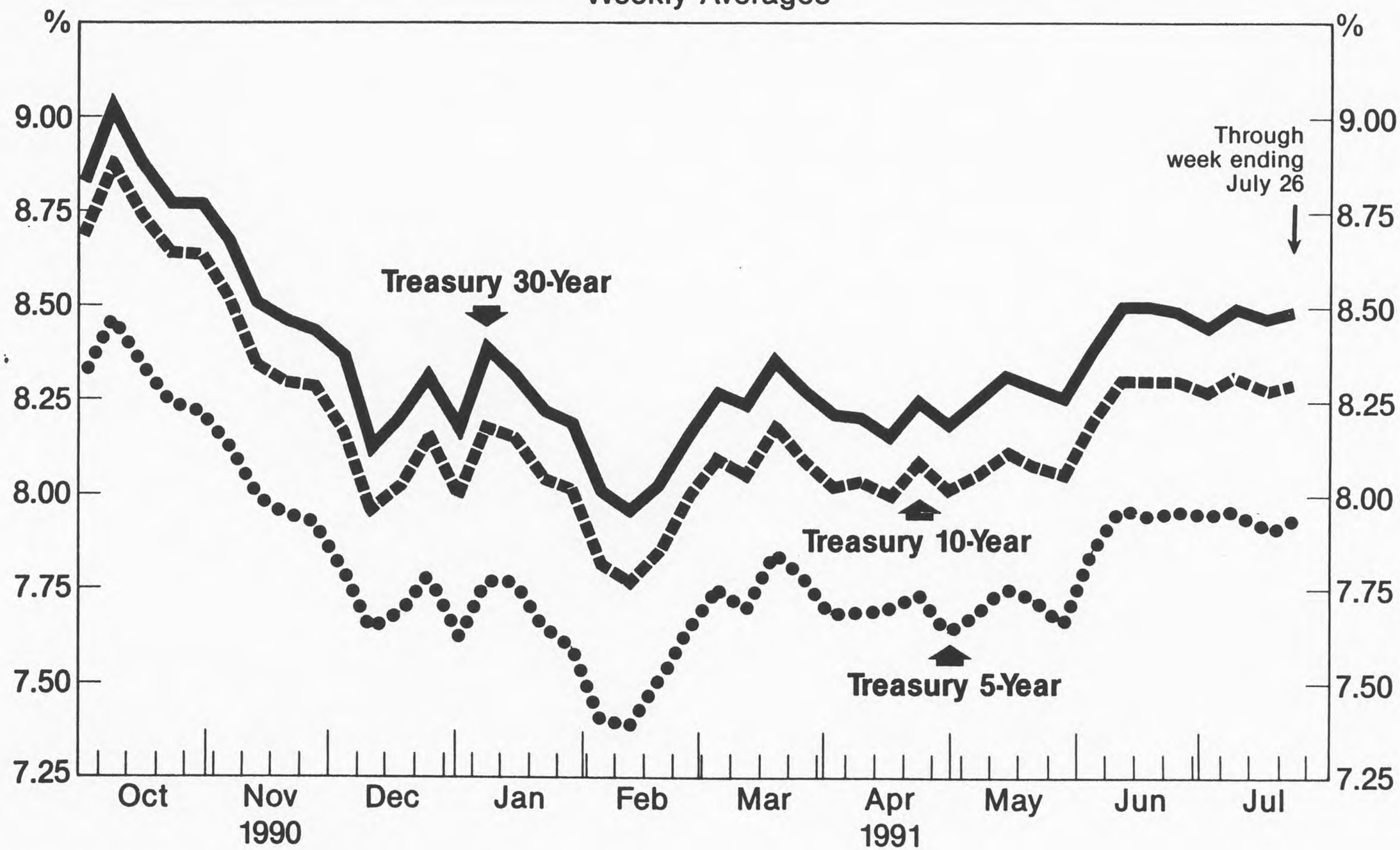
July 30, 1991-11

INTERMEDIATE AND LONG TERM TREASURY RATES

Weekly Averages



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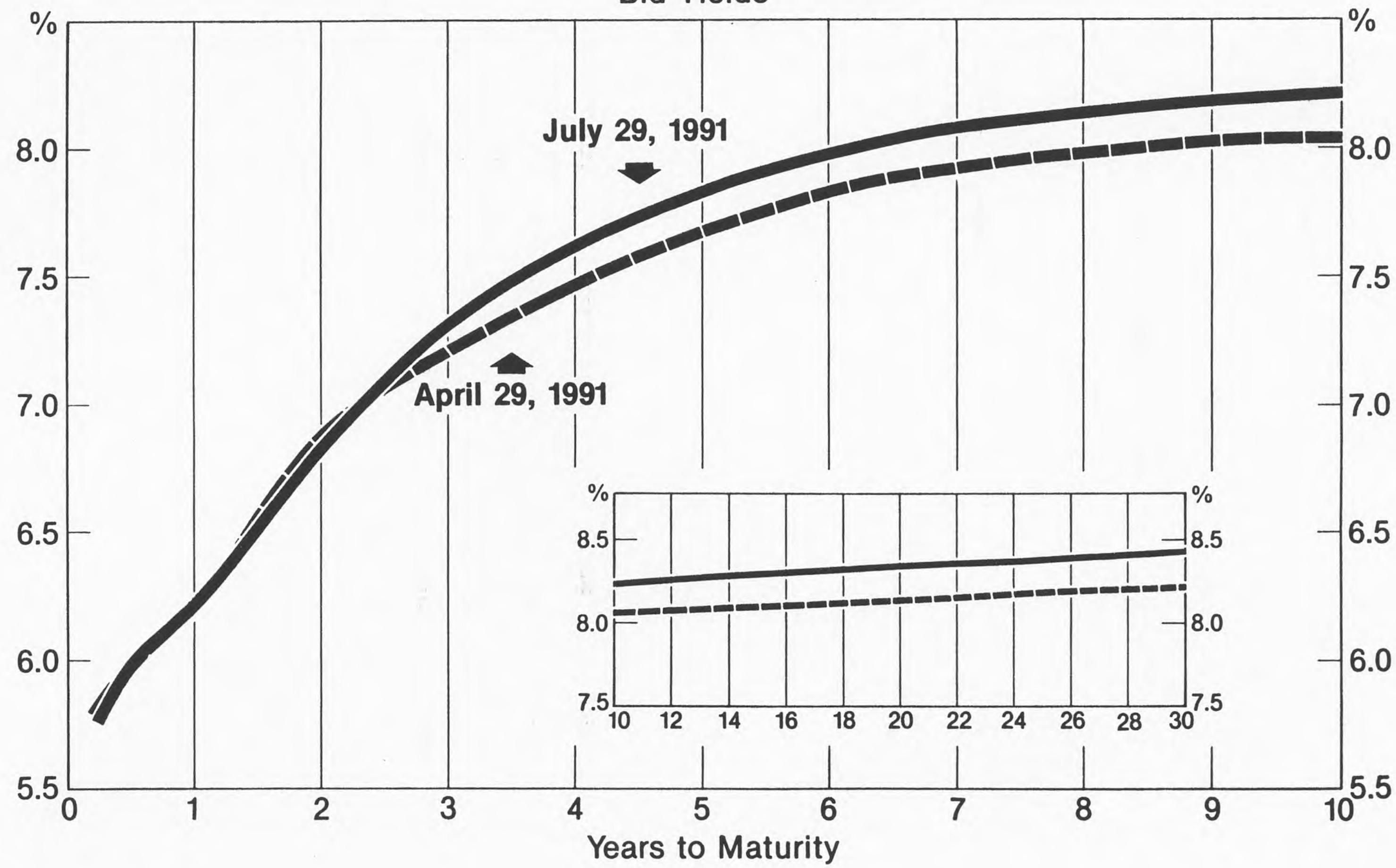
July 30, 1991-10

MARKET YIELDS ON GOVERNMENTS

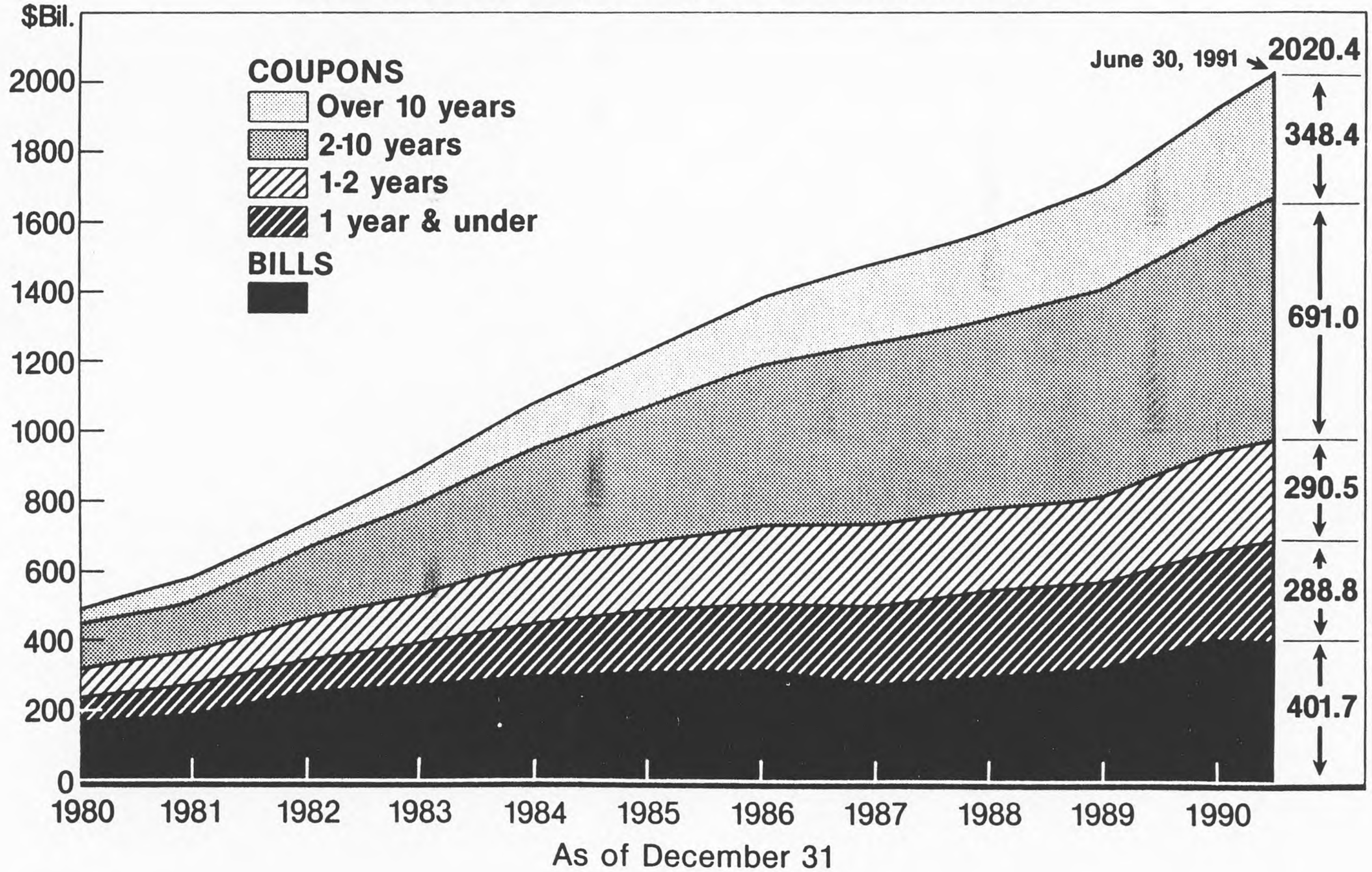
Bid Yields



Department of the Treasury
Office of Market Finance

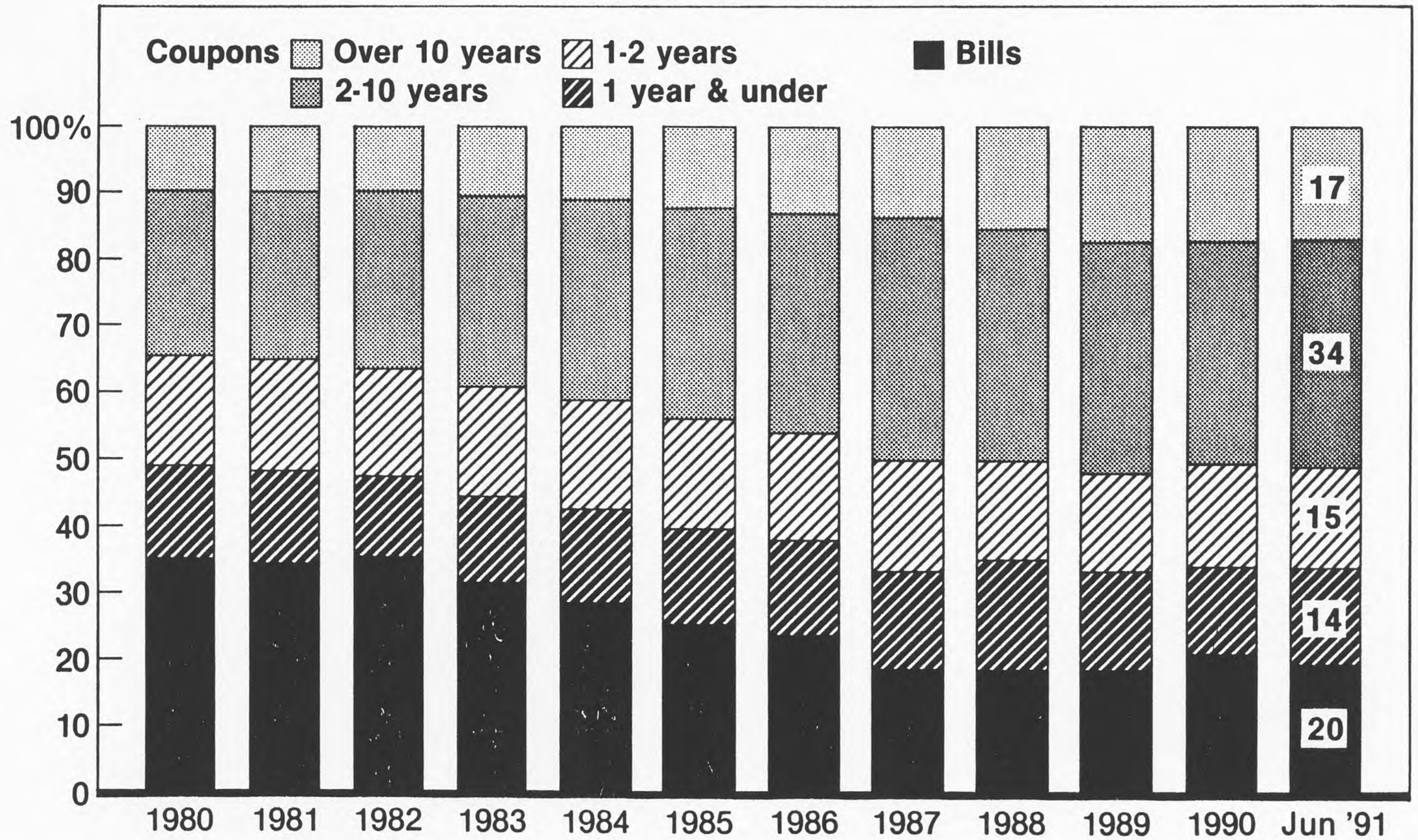
July 30, 1991-26

PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT BY MATURITY



PRIVATE HOLDINGS OF TREASURY MARKETABLE DEBT

Percent Distribution by Maturity



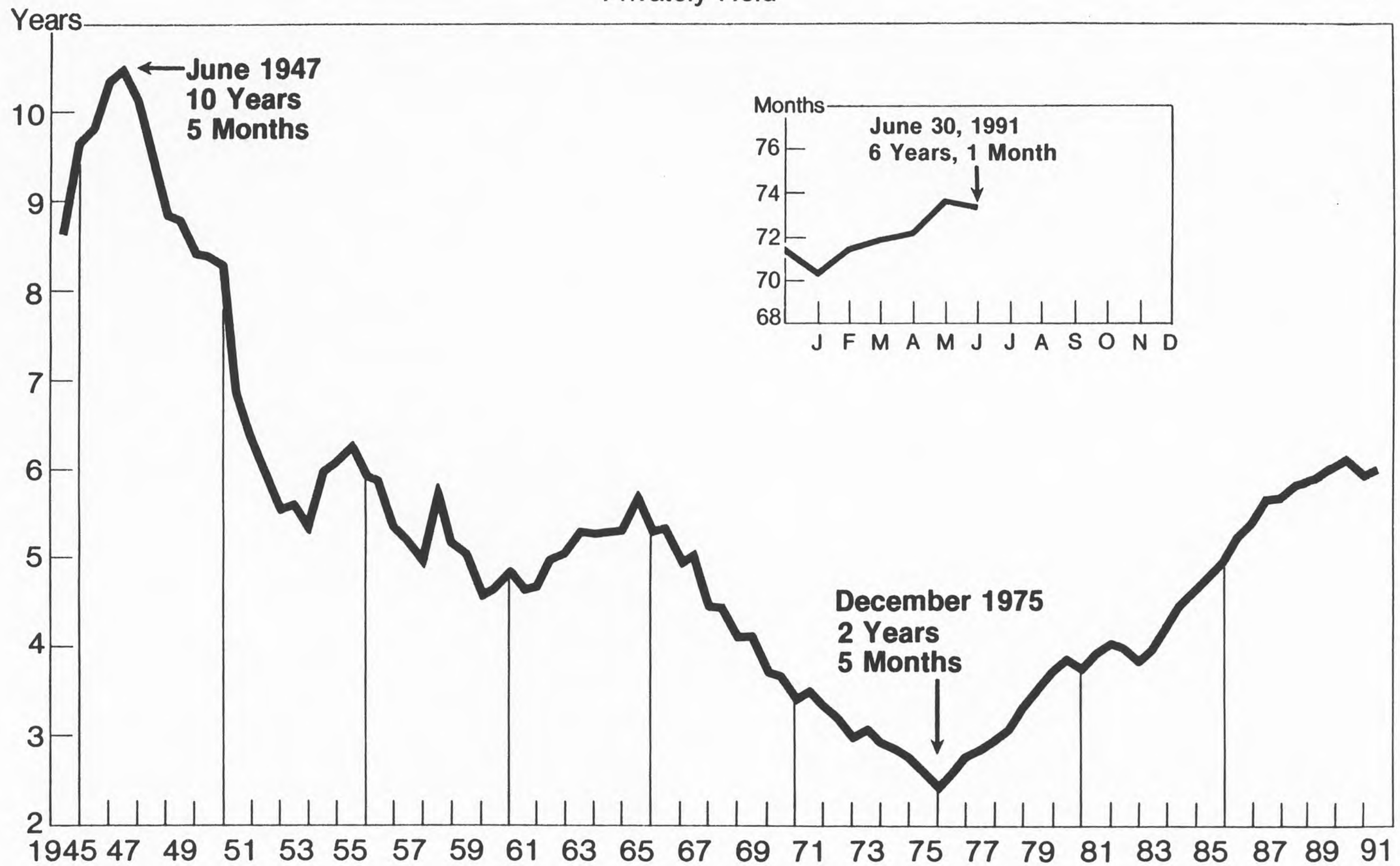
As of December 31

Department of the Treasury
Office of Market Finance

July 30, 1991-3

AVERAGE LENGTH OF THE MARKETABLE DEBT

Privately Held



MATURING COUPON ISSUES

August - December 1991

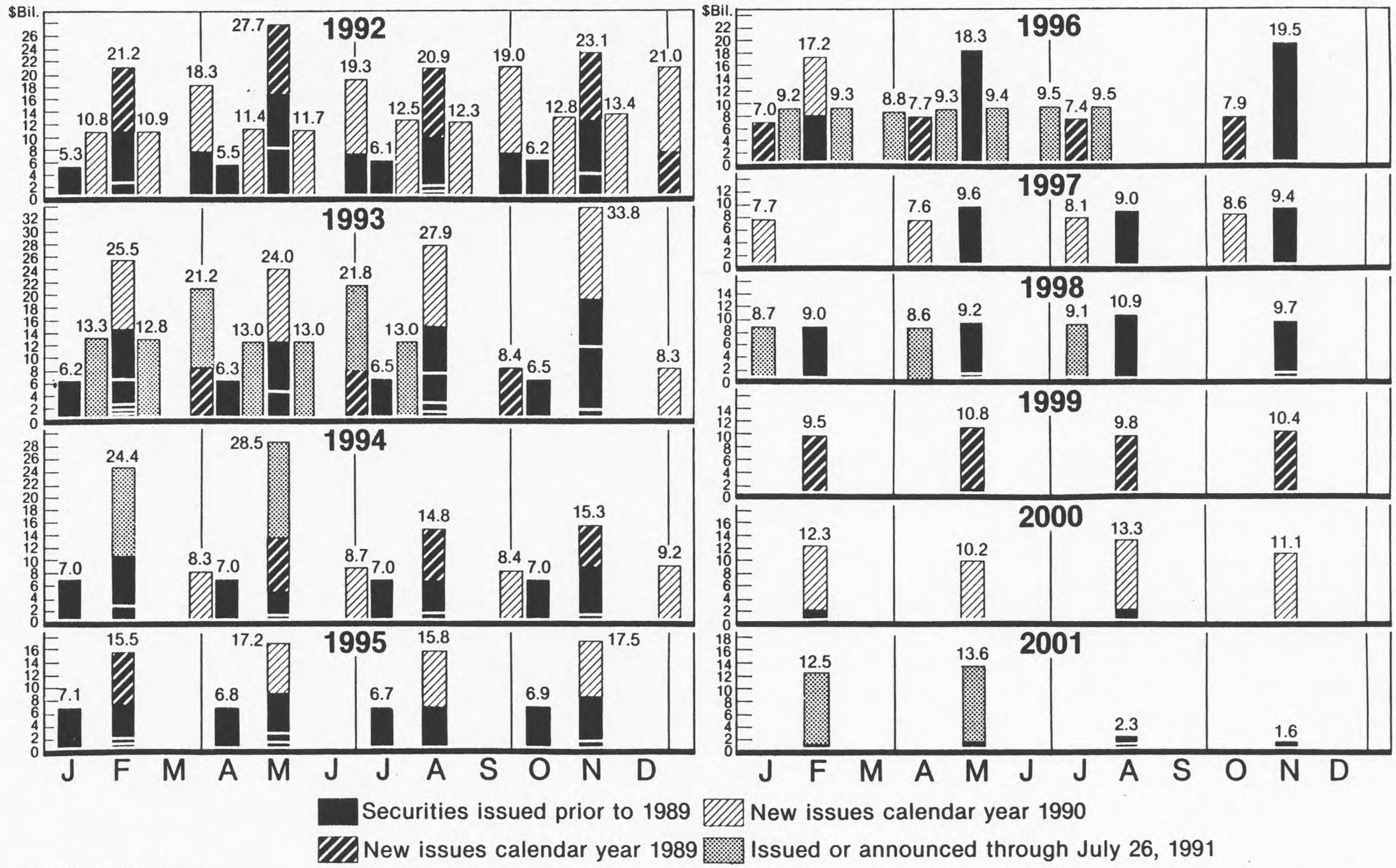
(In millions of dollars)

Maturing Coupons	June 30, 1991			
	Total	Held by		
		Federal Reserve & Government Accounts	Private Investors	Foreign Investors 1/
14 7/8% Note 8/15/91	2,812	558	2,254	17
7 1/2% Note 8/15/91	7,778	119	7,658	920
8 3/4% Note 8/15/91	13,490	1,766	11,724	494
8 1/4% Note 8/31/91	11,113	892	10,220	813
9 1/8% Note 9/30/91	7,919	460	7,459	451
8 3/8% Note 9/30/91	11,452	850	10,602	625
12 1/4% Note 10/15/91	5,745	347	5,398	476
7 5/8% Note 10/31/91	12,322	1,687	10,636	520
14 1/4% Note 11/15/91	2,886	635	2,252	45
8 1/2% Note 11/15/91	11,542	1,596	9,946	746
6 1/2% Note 11/15/91	8,346	229	8,117	674
7 3/4% Note 11/30/91	12,583	1,272	11,311	1,887
8 1/4% Note 12/31/91	8,083	791	7,292	829
7 5/8% Note 12/31/91	12,002	1,200	10,802	1,598
Totals	128,073	12,402	115,671	10,095

1/ F.R.B. custody accounts for foreign official institutions; included in Private Investors.

TREASURY MARKETABLE MATURITIES

Privately Held, Excluding Bills

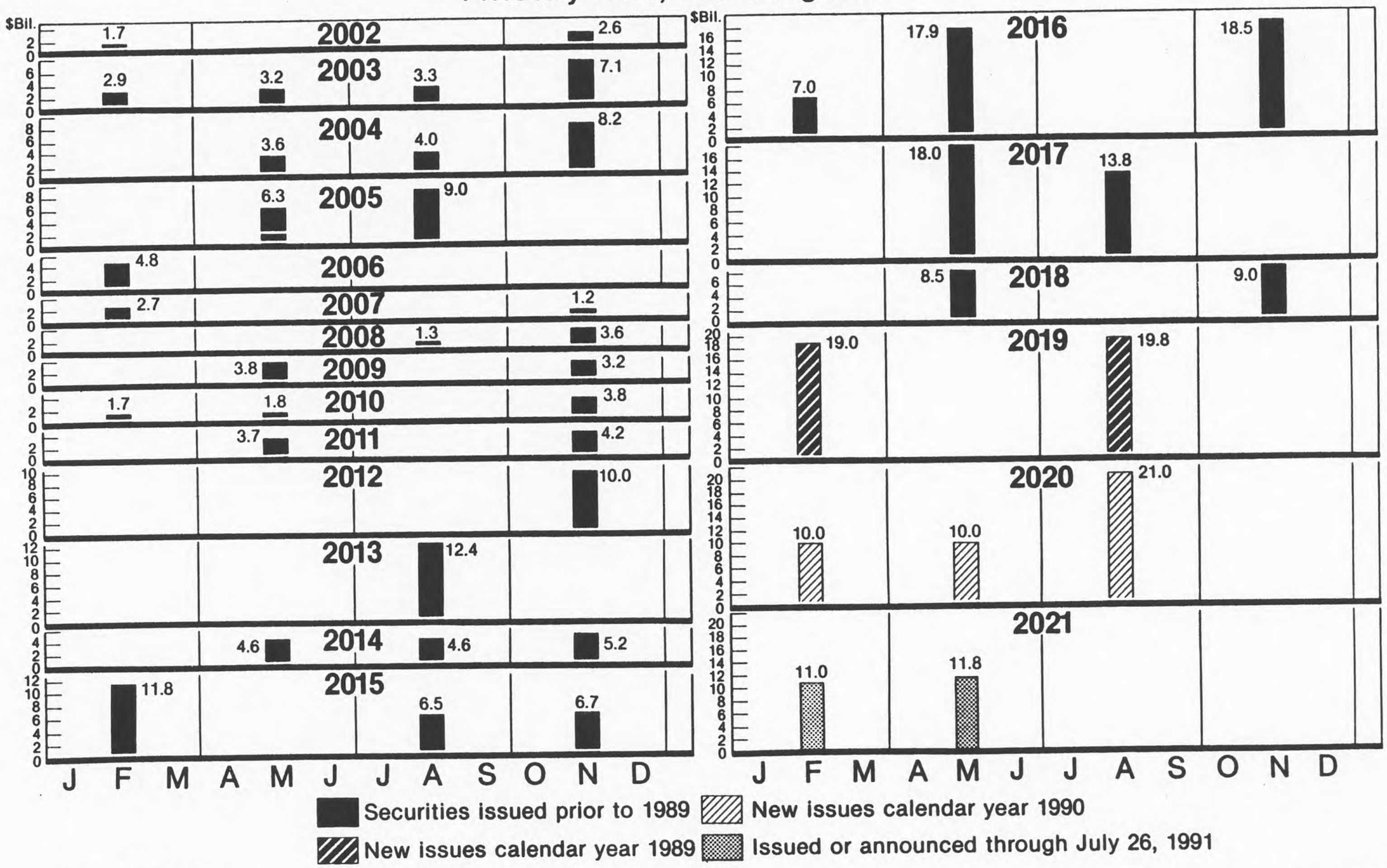


Department of the Treasury
Office of Market Finance

July 30, 1991-20

TREASURY MARKETABLE MATURITIES

Privately Held, Excluding Bills



Department of the Treasury
Office of Market Finance

July 30, 1991-21

SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN AUGUST 1991 1/

Monday	Tuesday	Wednesday	Thursday	Friday
			1	2
5	6 Auction 3 year 2/	7 Auction 10 year 2/	8 Auction 30 year 2/	9
12	13	14	15	16 Announce 52 week
19	20	21 Announce 2 year 5 year	22 Auction 52 week 3/	23
26	27 Auction 2 year 4/	28 Auction 5 year 4/	29	30

1/ Does not include weekly bills
2/ For settlement August 15
3/ For settlement August 29
4/ For settlement September 3

Department of the Treasury
Office of Market Finance

SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN SEPTEMBER 1991 1/

Monday	Tuesday	Wednesday	Thursday	Friday
2 Holiday	3	4	5	6
9	10	11	12	13 Announce 52 week
16	17	18 Announce 2 year 5 year	19 Auction 52 week 2/	20
23	24 Auction 2 year 3/	25 Auction 5 year 3/	26	27
30				

1/ Does not include weekly bills
2/ For settlement September 26
3/ For settlement September 30

Department of the Treasury
Office of Market Finance

July 30, 1991-13

SCHEDULE OF ISSUES TO BE ANNOUNCED AND AUCTIONED IN OCTOBER 1991 1/

Monday	Tuesday	Wednesday	Thursday	Friday
	1	2 Announce 7 year	3	4
7	8	9 Auction 7 year 2/	10	11 Announce 52 week
14 Holiday	15	16 Announce 2 year 5 year	17 Auction 52 week 3/	18
21	22	23 Auction 2 year 4/	24 Auction 5 year 4/	25
28	29	30	31	

1/ Does not include weekly bills
2/ For settlement October 15
3/ For settlement October 24
4/ For settlement October 31

Department of the Treasury
Office of Market Finance

July 30, 1991-14

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

MID-SESSION REVIEW OF THE BUDGET

NOTICE:

Embargoed: There should be no release of this document until 4:00 p.m. (E.D.T.) Monday, July 15, 1991

July 15, 1991

TABLE OF CONTENTS

GENERAL NOTES

1. All years referred to are fiscal years unless otherwise noted.
2. All totals in the text and tables include on-budget and off-budget spending and receipts unless otherwise noted.
3. Details in the tables and text may not add to totals because of rounding.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

The following is the text of the letter transmitting the Mid-Session Review of the Budget

July 15, 1991

Honorable Thomas S. Foley
Speaker of the House of Representatives
Washington, D.C. 20515

Dear Mr. Speaker:

Section 1106 of Title 31, United States Code, requires that the President transmit to the Congress a supplemental summary of the Budget that was transmitted to the Congress earlier in the year. This supplemental summary of the Budget, commonly known as the Mid-Session Review, contains revised estimates of the budget receipts, outlays, and budget authority for fiscal years 1991–1996 and other summary information required by statute.

The Review tends to show the following:

(1) The Administration's economic forecast used in developing the President's *Budget* has been highly accurate to date—and is modified only slightly herein.

(2) There has been a marked improvement in the deficit outlook for 1991—but, as is generally recognized, it has been caused principally by changes in deposit insurance and Desert Storm funding, which have offsetting adverse effects on the 1992 deficit.

(3) The budget reforms enacted in 1990 have been working—and the major changes in estimates have been in areas that are exempt from the new budgetary discipline (deposit insurance, Desert Storm, and technical reestimates).

(4) The structural deficit trend under current law remains favorable for the medium term—with the deficit falling to 1 percent of GNP in the mid-1990s.

At the President's direction, I have the honor to transmit the required Mid-Session Review of the Budget.

Respectfully yours,

Richard Darman
Director

Enclosure

IDENTICAL LETTER SENT TO THE HONORABLE DAN QUAYLE

I. DEFICIT OUTLOOK

In February, the President submitted a Budget consistent with the budget agreement reached last year with the Congress. The Budget stated that neither the full costs of Operation Desert Shield/Desert Storm nor the foreign contributions could be reliably estimated. It also noted, as the previous Budget had, that there were significant deficit forecasting problems caused by major uncertainties regarding estimated outlays for thrift and bank insurance and associated working capital requirements.

Putting Desert Storm and deposit insurance aside, the estimates in the President's Budget have proven to be quite accurate on the whole. Since February, the estimates of outlays for all government activities except Operation Desert Shield/Desert Storm and deposit insurance have changed by not more than 2 percent for any of the forecast years. However, because of more complete information on the incremental costs of Operation Desert Shield/Desert Storm and offsetting foreign contributions, the size and timing of the outlays and receipts that result from deposit insurance obligations, and a fall-off in tax collections to date, the deficit estimates have changed considerably. The estimated deficit for 1991 has improved markedly. It has decreased by $35.9 billion from $318.1 billion to $282.2 billion. But, as is generally recognized, this improvement in 1991 has an adverse carry-over effect upon the 1992 deficit. The timing effects of Desert Storm and deposit insurance flows have been the principal cause of an upward adjustment of the 1992 deficit, now forecast at $348.3 billion. As shown in Table 1, the deficit estimates for each year from 1993 through 1996 have also changed. However, the pattern of basic structural improvement in the deficit remains clear. Assuming the Administration's growth-oriented policies are enacted, along with necessary financial service sector reform, and assuming the Administration's economic forecast remains valid, then the deficit is projected to fall to 1% of GNP by the mid-1990's.

Table 1: MID-SESSION REVIEW: CHANGE IN POLICY DEFICITS

(In billions of dollars)

	1991	1992	1993	1994	1995	1996
February estimates	–318.1	–280.9	–201.5	–61.8	–2.9	19.9
Changes due to:						
Operation Desert Shield/Desert Storm	33.4	–12.0	–2.9	–1.3	–0.7	–0.3
Deposit insurance [1]	28.0	–29.9	–4.8	–12.7	2.8	7.5
Receipts	–22.8	–19.5	–19.4	–31.0	–40.2	–43.7
Debt service	0.3	0.5	–2.7	–5.3	–8.5	–11.2
All other changes [2]	–3.1	–6.5	–14.3	–20.0	–24.1	–27.6
Current estimates	–282.2	–348.3	–245.7	–132.1	–73.6	–55.5
Current estimates excluding Desert Shield/Desert Storm	–306.2	–331.5	–241.9	–130.4	–72.9	–55.2
Current estimates excluding deposit insurance	–198.7	–230.3	–196.7	–157.5	–118.8	–92.8
Current estimates excluding Deposit insurance and Desert Storm/Desert Shield	–222.7	–213.5	–192.9	–155.8	–118.1	–92.6
MEMORANDUM						
As a percent of GNP:						
Deficit	5.0	5.8	3.8	1.9	1.0	0.7
Deficit excluding Desert Shield/Desert Storm	5.5	5.6	3.8	1.9	1.0	0.7
Deficit excluding deposit insurance	3.5	3.9	3.1	2.3	1.6	1.2
Deficit excluding deposit insurance and Desert Storm/Desert Shield	4.0	3.6	3.0	2.3	1.6	1.2

[1] See discussion of deposit insurance change on page 6.

[2] Includes debt service on all other.

II. ECONOMIC ASSUMPTIONS

Economic developments so far this year have been consistent with those anticipated in the February budget. The recession was predicted to be short and shallow with a cumulative real GNP decline of 1.2 percent in the fourth quarter of 1990 and the first quarter of 1991. This was almost identical to the actual 1.1 percent real GNP decline during that period. In fact, the budget projection for the real GNP level in the first quarter of 1991 was within $4 billion (0.1 percent) of the actual outcome.

The economic assumptions used in the Mid-Session Review have been revised slightly from those of the budget to reflect new information. The projection of real GNP growth during the second half of 1991 has been raised somewhat, while that of the GNP implicit price deflator has been lowered. The level of nominal GNP by the fourth quarter of 1991 is the same as in the budget. For the Consumer Price Index, unemployment rate and interest rates, the recent slight differences between actual data and those assumed in the February budget are phased out smoothly. As a result the changes in economic assumptions since the budget have only very small effects on outlays, receipts, and the deficit. (See tables 4 and 8.)

Table 2. ECONOMIC ASSUMPTIONS

(Calendar years; dollar amounts in billions)

	Actual 1990	Estimates					
		1991	1992	1993	1994	1995	1996
Major economic indicators:							
Gross national product (percent change, fourth quarter over fourth quarter):							
Current dollars ("nominal GNP")	4.5	5.0	7.5	7.3	6.8	6.6	6.4
Constant (1982) dollars ("real GNP")	0.5	0.8	3.6	3.4	3.2	3.0	3.0
GNP deflator (percent change, fourth quarter over fourth quarter)	4.0	4.2	3.8	3.7	3.5	3.4	3.3
Consumer Price Index (percent change, fourth quarter over fourth quarter) [1]	6.2	3.4	3.9	3.7	3.5	3.4	3.3
Unemployment rate (percent, fourth quarter) [2]	5.8	6.7	6.3	6.2	5.8	5.4	5.2
Annual economic assumptions:							
Gross national product:							
Current dollars ("nominal GNP"):							
Amount	5,465	5,674	6,076	6,521	6,976	7,442	7,923
Percent change, year over year	5.1	3.8	7.1	7.3	7.0	6.7	6.5
Constant (1982) dollars ("real GNP"):							
Amount	4,157	4,149	4,281	4,430	4,577	4,719	4,861
Percent change, year over year	1.0	–0.2	3.2	3.5	3.3	3.1	3.0
Incomes:							
Personal income	4,646	4,853	5,187	5,533	5,910	6,291	6,676
Wages and salaries	2,705	2,801	3,007	3,236	3,455	3,688	3,931
Corporate profits before tax	305	301	343	388	434	463	490
Price level:							
GNP deflator:							
Level (1982=100), annual average	131.5	136.7	141.9	147.2	152.4	157.7	163.0
Percent change, year over year	4.1	4.0	3.8	3.7	3.5	3.5	3.4
Consumer Price Index: [1]							
Level (1982-84=100), annual average	129.0	134.7	139.9	145.1	150.3	155.4	160.6
Percent change, year over year	5.3	4.4	3.8	3.8	3.6	3.4	3.3
Total unemployment rate, annual average [2]	5.4	6.6	6.4	6.3	5.9	5.5	5.2
Federal pay raise, January (percent)	3.6	4.1	4.2	4.7	4.3	4.1	4.0
Interest rates (percent):							
91-day Treasury bills [3]	7.5	5.7	5.9	5.8	5.6	5.4	5.3
10-year Treasury notes	8.5	8.0	7.8	7.0	6.6	6.4	6.3

[1] CPI for urban wage earners and clerical workers. Two versions of the CPI are published. The index shown here is that currently used, as required by law, to calculate automatic cost-of-living increases for indexed Federal programs.

[2] Percent of total labor force, including armed forces residing in the U.S. This implies an average unemployment rate of 6.4% for the second half of calendar year 1992.

[3] Average rate on new issues within period, on a bank discount basis.

Table 3: FEBRUARY BUDGET GNP FORECAST AND ACTUAL DATA

(Dollar amounts in billions)

	GNP, Annual Rate		Error in Level (%)
	Forecast	Actual	
Nominal GNP:			
Q4, 1990	5,527	5,527	—
Q1, 1991	5,574	5,558	–0.3
Real GNP (1982 dollars):			
Q4, 1990	4,134	4,153	0.5
Q1, 1991	4,121	4,124	0.1

298-090 O - 91 - 2 QL:3

III. RECEIPTS

The current estimates of receipts for 1991 and 1992 are lower than the February estimates by $22.8 billion and $19.5 billion, respectively. Most of these differences are the result of technical reestimates, which account for $21.2 billion and $17.8 billion of the 1991 and 1992 differences, respectively.

Technical reestimates for individual income tax receipts account for approximately one-half of the total technical change for 1991 and 1992. The reestimates reflect adjustments in the light of lower than anticipated tax collections relating to final payments of calendar year 1990 individual income tax liability. Negative technical adjustments have also been made to employment taxes, excise taxes, and Federal Reserve earnings.

Table 4: MID-SESSION REVIEW: CHANGE IN POLICY RECEIPTS

(In billions of dollars)

	1991	1992	1993	1994	1995	1996
February estimate	1,091.4	1,165.0	1,252.7	1,365.3	1,467.3	1,560.7
Changes due to:						
Technical reestimates	–21.2	–17.8	–16.5	–24.7	–33.7	–36.0
Economic assumptions	–1.3	–1.7	–2.9	–6.3	–6.5	–7.7
Policy	–0.3	–*	*	—	—	—
Total, changes	–22.8	–19.5	–19.4	–31.0	–40.2	–43.7
Mid-Session estimate	1,068.7	1,145.5	1,233.3	1,334.3	1,427.1	1,517.0

Source: Department of the Treasury, Office of Tax Analysis.

IV. SPENDING

Outlays

The current estimate for outlays for 1991 is $1,305.9 billion, $58.7 billion lower than the February estimate. This reduction is largely due to reestimates of the size and timing of outlays and receipts that result from deposit insurance obligations, and different spending patterns and contributions for Operation Desert Shield/Desert Storm than assumed in the "placeholder" estimates in February. The current estimate for outlays in 1992 is $1,493.8 billion, $47.9 billion higher than the February estimate.

Operation Desert Shield / Desert Storm

Estimates in the February budget included a "placeholder" for Desert Shield/Desert Storm costs because it was too early in the operation to project costs accurately. The Budget assumed 1991 funding of $30.0 billion, of which $15.0 billion would be offset by foreign contributions, and 1991 net outlays of $9.4 billion. (See table 5.)

Table 5: DESERT SHIELD/DESERT STORM APPROPRIATIONS AND CONTRIBUTIONS

(In billions of dollars)

	Budget Authority 1991	Outlays		
		1991	1992	1993 and Beyond
February 1991 Request:				
Appropriations:				
1990 Supplemental (P.L. 101–403)	—	0.4	0.1	0.1
1991 DOD Appropriations Act	1.0	0.8	0.2	—
Placeholder Allowance	29.0	23.2	4.6	1.2
Total Appropriations	[1] 30.0	24.4	4.8	1.2
Offsetting Receipts	–15.0	–15.0	—	—
Net Funding	15.0	9.4	4.8	1.2
Mid-Session Update:				
Appropriations:				
1990 Supplemental	—	0.4	0.1	0.1
1991 Appropriations Act	1.0	0.8	0.2	—
Desert Storm Supplemental (P.L. 102–28)	42.6	27.8	10.9	3.4
Dire Emergency Supplemental (P.L. 102–27)	[2] 0.7	0.4	0.2	0.2
Dire Emergency Supplemental (P.L. 102–55)	[3] 0.3	0.1	0.1	*
Proposed Supplemental	2.9	–5.3	5.4	2.7
Total Appropriations	[1] 47.5	24.2	16.8	6.2
Offsetting Receipts	–48.2	–48.2	—	—
Net Funding	–0.7	–24.0	16.8	6.2
Difference: Mid-session vs. February 1991 Request:				
Net Outlays		–33.4	12.0	5.0

[1] This does not reflect the 1990 supplemental appropriation of $2.0 billion.

[2] This includes $0.4 billion for DOD and $0.3 billion for the Departments of Education and Veterans Affairs. The non-defense funding includes advance appropriations for 1992 through 1995.

[3] This includes funding of $235 million for the Department of State and $16 million for the Department of Defense.

The Department of Defense has estimated that the full incremental costs of Desert Shield/Desert Storm could total $61.1 billion. The portion that requires appropriations in 1991 and is exempt from statutory budget ceilings is $47.5 billion. This excludes those costs covered by in-kind assistance from allies, long-term veterans benefits, 1990 costs, and costs for expended and destroyed equipment that the Department does not currently plan to replace.

Outlays currently are estimated to be about $33.4 billion less in 1991 and $12.0 billion more in 1992 than assumed in the February budget "placeholder" estimates. Current estimates assume that in addition to cash contributions of $39.0 billion that have been received through July 12th, additional pledged contributions of $9.2 billion will be received in 1991, for a total of $48.2 billion. Contributions exceed U.S. disbursements in 1991 because disbursements—especially those involving contracts and budget authority that involve low outlay spend-out rates— will occur over an extended period. Under the Persian Gulf Conflict Supplemental Authorization Act and Personnel Benefits Act of 1991 (Public Law 102–25), OMB is obliged on the 15th of each month to report to the Congress on the status of Desert Shield expenditures and associated foreign contributions. The July 15th report is included as an Appendix to this report.

Economic changes

Changes in economic conditions have reduced outlay estimates by $1.9 billion in 1991 and $4.5 billion in 1992 from the levels in the February budget. This largely reflects the more modest rise in the consumer price index resulting in smaller cost-of-living increases for social security and other retirement programs than previously assumed. It also reflects the pattern of interest rate changes where short-term interest rates have been lower than projected in the budget, while long-term rates have been somewhat higher. These interest rate changes have the effect of reducing outlay estimates in 1991 and 1992, while increasing them in subsequent years.

Technical changes

Technical changes result from factors such as revised crop forecasts affecting farm price support costs, changes in estimated caseloads for entitlement programs, and other non-economic, non-policy conditions different from those previously assumed. The largest technical reestimates are for deposit insurance, where the magnitude and timing of outlays and receipts are inherently difficult to estimate. Only the major technical reestimates are reflected in this document.

Commodity Credit Corporation (CCC)—CCC net expenditures rise during 1991 through 1995 from $49.3 billion in the February budget to $55.2 billion. Of this $6 billion increase, about half ($2.6 billion) results from new supply and demand equations for cereals. Specifically, the Department of Agriculture projects greater wheat consumption, which decreases budget outlays by $1.1 billion, and lower corn exports, which increases budget outlays by $3.7 billion. Most of these changes occur in the outyears, but are simply derived by extrapolating from current market conditions, such as disappointing Soviet purchases of corn this year.

The remaining increase in CCC net expenditures is for the Export Enhancement Program (EEP). Bonuses paid to subsidize the export of U.S. crops have been in the form of generic certificates backed by commodity stocks held by CCC. With CCC stocks nearly depleted, the Department of Agriculture will make bonus payments in cash for the first time in 1992. Direct cash outlays, unlike CCC corn stocks acquired as part of the price support program, are reported as an EEP expenditure. The outlays associated with use of certificates were recorded much earlier when farmers defaulted on loans to CCC and the Government took title to the grain pledged as collateral. As has been the case in the past, EEP benefits, in the form of lower CCC subsidy payments, are already reflected in the estimates. The EEP has been, and still is, scored as budget neutral.

Deposit insurance—Net outlays for three deposit insurance accounts—the Resolution Trust Corporation (RTC), the Bank Insurance Fund (BIF), and the FSLIC Resolution Fund (FRF)—are expected to be $28.0 billion lower in 1991 and $29.9 billion higher in 1992 than the February budget estimates. Deposit insurance net outlays for 1993 and beyond are also estimated to differ from the February estimates—up $4.8 billion in 1993 and $12.7 billion in 1994, but down $2.8 billion in 1995 and down $7.5 billion in 1996. The volatility of these estimates, especially for the RTC and BIF, reflect the substantial uncertainty about key parameters affecting deposit insurance expenditures. These key parameters include:

- availability of sufficient funding to assure timely resolution of failed institutions;
- the financial condition and structure of asset portfolios of failed depository institutions;
- the administrative ability of the Federal banking agencies to process effectively the number and size of depository institutions projected to fail;

- the rate of Federal acquisition and sale of associated assets; and
- the projected general economic and specific regional real estate market conditions that affect both the probability of an institution failing and the ability of the Federal banking agencies to dispose of the acquired assets from failed institutions efficiently and quickly.

There is, in addition, uncertainty as to the timing and content of financial sector reform legislation. Table 6 indicates OMB's current estimates of the potential range of outlays that could occur for the deposit insurance accounts during the 1991 through 1996 period.

Table 6: POTENTIAL RANGE OF ESTIMATES OF FEDERAL DEPOSIT INSURANCE OUTLAYS

(In billions of dollars)

	1991	1992	1993	1994	1995	1996
Resolution Trust Corporation:						
Mid-Session Review Estimate	62.2	97.6	19.3	−39.7	−38.9	−26.0
Potential Range of Estimate	45 to 62	84 to 119	−14 to 51	−41 to −40	−39 to −38	−27 to −24
FSLIC Resolution Fund:						
Mid-Session Review Estimate	9.2	7.0	6.0	*	*	0.3
Potential Range of Estimate	—	4 to 12	0 to 6	0 to 2	0 to 2	0 to 2
Bank Insurance Fund:						
Mid-Session Review Estimate	12.1	14.4	24.5	13.8	−6.0	−11.7
Potential Range of Estimate	11 to 16	10 to 38	7 to 37	−6 to 14	−17 to −2	−17 to −1
Total, Federal Deposit Insurance: [1]						
Mid-Session Review Estimate	83.5	118.0	49.0	−25.4	−45.2	−37.4

[1] Includes outlays for other deposit insurance of −$1.0, −$0.8, $0.4, −$0.3 billion in 1992–1995, respectively. Amounts for 1991 and 1996 are less than $50 million.

NOTE: Estimates range widely due to differing assumptions about the rate of case resolution, the losses associated with marking to market, the rates of asset acquisition and sale, and perhaps, most significantly, the associated variations in requirements for working capital.

The reduction in 1991 deposit insurance net outlays reflects fewer case resolutions than originally forecast. The delay in obtaining additional RTC loss funding for 1991 contributed to this lower level of resolution activity in 1991. The 1992 net outlay increase is predicated upon the assumption that the Congress provides the RTC loss funding and BIF recapitalization requested by the Administration fully and promptly to avoid any delays in 1992 and 1993.

Outlays in any one year may swing widely from this projection, depending upon the timing and size of specific closure actions dealing with failed banks. The Administration's 1992 budget showed the net worth of the BIF declining to negative $2.2 billion in 1992 and negative $22.2 billion by 1996. At the time this was a more pessimistic forecast than those of the banking agencies and the Congressional Budget Office. Now, the forecasts of some Federal agencies are beginning to show the same negative trend. In particular, FDIC Chairman Seidman has revised his earlier estimates. He has indicated (on June 27th) that BIF net worth would decline to at least negative $3 billion, and very possibly as high as negative $11 billion, for the end of calendar year 1992. The complete data available to FDIC is not yet available to OMB. OMB has, therefore, made only a preliminary revision of the BIF estimate. Analysis of banking data from the first quarter of 1991, not yet available to OMB, as well as reviews of the updated forecasts of the FDIC and others, may lead to a further upward revision in the Administration's estimates.

Working capital needs—the funding required to purchase temporarily assets intended for future sale—is one of the most volatile components of deposit insurance outlays. This is especially true for the current revisions for BIF outlays. As shown in Table 7, the vast majority of these BIF outlay changes in 1992 through 1996 is the result of changes in estimates of needs for working capital.

Table 7: BANK INSURANCE FUND/RESOLUTION TRUST CORPORATION OUTLAYS AND WORKING CAPITAL

(In billions of dollars)

	1991	1992	1993	1994	1995	1996
Bank Insurance Fund:						
Outlays:						
February estimate	15.9	9.7	8.0	6.8	0.9	0.6
Mid-Session estimate	12.1	14.4	24.5	13.8	–6.0	–11.7
Difference	–3.8	4.6	16.5	7.0	–6.9	–12.3
Working capital:						
February estimate	7.0	3.6	1.1	0.1	–3.5	–2.3
Mid-Session estimate	7.5	7.3	14.2	7.2	–6.1	–9.1
Difference	0.4	3.7	13.0	7.1	–2.6	–6.9
Percentage change in outlays due to change in working capital	–11.4	80.0	79.2	100.9	37.7	55.7
Resolution Trust Corporation:						
Outlays:						
February estimate	84.6	76.1	34.3	–47.6	–45.7	–32.0
Mid-Session estimate	62.2	97.6	19.3	–39.7	–38.9	–26.0
Difference	–22.3	21.6	–14.9	7.9	6.8	6.0
Working capital:						
February estimate	55.4	44.5	12.9	–47.8	–45.9	–32.2
Mid-Session estimate	38.4	55.0	0.3	–39.9	–39.1	–26.2
Difference	–17.0	10.5	–12.6	7.9	6.8	6.0
Percentage change in outlays due to change in working capital	76.3	48.6	84.1	100.0	100.0	100.0

Food stamps—Estimated outlays for food stamps are $0.7 billion and $1.8 billion above the February estimates for 1991 and 1992, respectively, for technical reasons. Both the number of participants in the program and the average monthly benefit per person are expected to be higher than assumed in February. Pursuant to the Dire Emergency Supplemental Appropriations for Consequences of Operation Desert Shield/Desert Storm, Food Stamps, Unemployment Compensation Administration, Veterans Compensation and Pensions, and Other Urgent Needs Act of 1991 (Public Law 102–27), the Administration is requesting the additional $1.3 billion in budget authority for food stamps for 1991 included in that Act.

Medicaid—Technical reestimates for the Medicaid program, $2.2 billion in 1991 and $5.7 billion in 1992, reflect an increase in state-estimated Medicaid expenditures. The increase in state-estimated Federal Medicaid expenditures appears to be due to:

- substantial increases in inpatient hospital payments, particularly state add-ons to specific hospitals, in part funded through provider taxes and refundable donations;
- increased numbers of beneficiaries; and
- a generally unpredicted upturn in acute health care costs.

These estimates do not reflect the level of outlays associated with regulations under development to deal with the improper use of refundable donations and taxes.

The use of provider tax and donation schemes—and other causes of rising Medicaid estimates—are described in more detail in "Improving Medicaid Estimates: Report of the HHS-OMB Task Force," July 10, 1991. (This is included at Appendix A.)

Medicare—Total outlays for 1991 to 1996 for Medicare change less than 0.2 percent as a result of technical reestimates. Revised outlay estimates for the hospital insurance trust fund are 0.7 percent above the February budget estimates for 1991 through 1996 due to higher beneficiary participation rates. About half of that increase occurs in 1995 ($0.8 billion) and 1996 ($1.0 billion). Other significant factors are higher utilization of skilled nursing facilities and home health agencies.

Revised outlay estimates for the supplementary medical insurance trust fund are 0.9 percent lower for 1991 through 1996. These technical decreases reflect lower independent laboratory projections due to recent actual data, and reduced spending for physician services due to lower residual payments and implementation of the conversion factor adjustment in the proposed physician fee schedule. Outlays for 1991 and 1992 increase by 1.2 percent and 1.4 percent, respectively, due to increased beneficiary participation in the program.

Social Security—Estimated outlays for Social Security are lower than projected in February for 1991 and 1992 but are above the February projections in the outyears. The increases are due to higher average program awards for the Old Age and Survivors Insurance program and an increase in the incidence of disability among workers covered under the Disability Insurance program. In the near term, these increases are more than offset by a reduction in the number of retired workers on the rolls relative to the February assumptions.

Unemployment insurance—Estimated outlays for unemployment compensation benefits are higher than the February projections for all years. For 1991, benefits outlays are expected to increase only slightly ($20 million), with a larger increase in 1992 ($1.0 billion). The increases are due to an upward reestimate in the insured unemployment rate (IUR). This technical reestimate is based largely on experience in the most recent calendar quarter, the only quarter of the fiscal year in which the actual IUR has been higher than projected in February. These estimates will be monitored closely to determine whether experience in subsequent quarters is consistent with experience in the most recently completed quarter.

Veterans programs—Estimated outlays for veterans compensation, pensions, and readjustment benefits are above the February estimate by $0.2 billion in both 1991 and 1992 because of a higher-than-anticipated number of beneficiaries and higher average benefits. These increases have been reflected in action on the 1991 supplemental appropriations bills.

Table 8: MID-SESSION REVIEW: CHANGE IN POLICY OUTLAYS

(In billions of dollars)

	1991	1992	1993	1994	1995	1996
February estimate	1,409.6	1,445.9	1,454.2	1,427.1	1,470.3	1,540.8
Changes due to:						
Desert Shield/Desert Storm	–33.4	12.0	2.9	1.3	0.7	0.3
Technical reestimates:						
Commodity Credit Corporation	–0.3	0.8	2.2	1.8	1.4	1.1
Deposit insurance	–28.0	29.9	4.8	12.7	–2.8	–7.5
Food stamps	0.7	1.8	1.8	1.5	1.4	1.3
Medicaid	2.2	5.7	8.6	12.5	15.9	19.1
Medicare	0.5	0.9	0.4	–0.3	–1.0	–2.1
Social Security	–0.4	–0.1	0.4	1.0	1.5	2.0
Unemployment insurance	*	1.0	0.7	0.8	0.5	0.2
Veterans programs	0.2	0.2	0.2	—	—	—
Net interest [1]	*	0.1	3.5	7.4	12.0	16.2
Subtotal, technicals	–25.0	40.2	22.7	37.5	29.0	30.3
Economic assumptions:						
Social Security and other retirement	*	–2.6	–3.8	–3.9	–3.5	–3.2
Other	–0.1	–0.9	–1.0	0.5	0.6	0.7
Net interest:						
Interest rate effect	–1.8	–0.9	3.8	3.8	2.9	2.4
Debt service	–*	–0.1	–0.2	0.1	0.6	1.0
Subtotal, economic	–1.9	–4.5	–1.1	0.5	0.6	0.9
Policy:						
Discretionary programs	1.6	0.1	0.1	–0.1	–*	*
Pay-as-you-go legislation	–*	–*	—	—	—	—
Debt service	*	0.1	0.2	0.2	0.2	0.2
Total, policy	1.6	0.2	0.3	*	0.2	0.2
Total, changes	–58.7	47.9	24.7	39.4	30.5	31.7
Mid-Session estimate	1,350.9	1,493.8	1,478.9	1,466.4	1,500.7	1,572.5

[1] Includes debt service impact of Operation Desert Shield/Desert Storm.

Policy changes

Since the budget was submitted, the Congress has completed action on three supplemental appropriations bills and ten bills with pay-as-you-go implications. The Administration has also submitted several budget amendments. In total, enacted Congressional and Administration policy changes have increased outlays by $1.6 billion in 1991 and by $0.2 billion in 1992.

Budget Authority

Total discretionary budget authority for 1991 is $18.8 billion above the February budget estimate. Nearly all of this increase is the result of appropriations for Operation Desert Shield/Desert Storm above the levels assumed in the Budget placeholder. Discretionary budget authority for 1992 is nearly the same as in the February budget.

Table 9: MID-SESSION REVIEW: CHANGE IN POLICY DISCRETIONARY BUDGET AUTHORITY

(In billions of dollars)

	1991	1992	1993	1994	1995	1996
February estimate [1]	523.4	522.7	515.6	517.3	523.6	535.0
Changes due to:						
Desert Shield/Desert Storm	17.2	0.1	0.1	*	*	—
Policy:						
Defense	0.3	–0.1	–*	–*	–*	–*
International	0.9	—	—	—	—	—
Domestic	0.4	–0.1	*	*	—	—
Total, policy	1.5	–0.1	*	—	–*	–*
Total, changes	18.8	*	0.1	*	*	–*
Mid-Session estimate	542.2	522.8	515.7	517.3	523.6	535.0

[1] Includes Desert Shield/Desert Storm placeholder.

V. STATUS OF PAY-AS-YOU-GO LEGISLATION AND DISCRETIONARY SPENDING

This chapter also presents the current status of enacted and pending legislation subject to the pay-as-you-go provisions of the Omnibus Budget Reconciliation Act of 1990 (OBRA), and the current status of 1992 appropriations bills and the discretionary limits established in OBRA. According to OBRA, the changes in economic assumptions and technical estimates that are discussed in this report may not be taken into account when OMB prices legislation subject to the pay-as-you-go provisions or the discretionary limits.

Pay-as-you-go Legislation

The Omnibus Budget Reconciliation Act of 1990 (OBRA) requires that all revenue and direct spending legislation meet a pay-as-you-go requirement. That is, no such bill should result in an increase in the deficit; and if it does, it must trigger a sequester if not fully offset.

To date, 10 bills that have pay-as-you-go implications have been enacted. In total, they decrease the deficit by $31 million for the two years 1991 and 1992. An additional 10 bills have passed the House or Senate but have not yet been enacted. Based on preliminary scoring, if all these bills were enacted into law, a small across-the-board reduction could be required.

Discretionary Spending

Status of discretionary spending limits

OBRA also specified limits on discretionary spending. Separate limits were established for defense, international affairs, and domestic programs for each year 1991 to 1993. If either budget authority or outlays exceed the limits in any year, there will be an automatic reduction in the category in which the breach occurred.

Since the February budget, the Congress has enacted three appropriations bills. As required under the law, the discretionary spending limits have been adjusted for the emergency appropriations provided in these bills, for the incremental costs of Operation Desert Shield/Desert Storm, and for other purposes. For defense and international discretionary programs, the enacted changes were consistent with the requirements of OBRA. For domestic discretionary programs, the enacted bills increased budget authority above the cap for 1991 by $2.4 million. An across-the-board reduction of .0013 percent was ordered. Table 11 shows the current status of the discretionary spending limits.

Status of 1992 appropriations bills

As this document goes to press (July 13, 1991), the House has passed 12 of the 13 appropriations bills. The Senate has not yet passed any appropriations bills. House action on defense and international appropriations bills is below the discretionary limits. Although the House has not completed action on all of the domestic bills, it appears that the House action, when completed, could exceed the domestic limits by as much as $1.5 billion in outlays, using OMB scoring. Detailed descriptions of OMB scoring of appropriations bills have been provided to the Appropriations Committees as the bills have been considered by the House and the Senate.

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TABLE 10: PAY-AS-YOU-GO LEGISLATION

(In millions of dollars)

	Change in the baseline deficit					
	1991	1992	1993	1994	1995	1991–1995
Legislation enacted through July 7th: [1]						
OMB estimate	–*	–31	*	*	*	–30
CBO estimate	6	–44	10	148	171	292

Discussion of differences:

Differences in pay-as-you-go estimates of legislation enacted in this session are primarily due to the scoring of increased Veterans' educational benefits in Public Law 102–25. The increases are not scored as direct spending for 1991 through 1993 because the funds are only available through an appropriations act. For 1994 and 1995, OMB assumes that the Secretary will return to the benefit rates paid in 1991. CBO assumes the Secretary will continue the new rates into 1994 and 1995 and index them for inflation.

	1991	1992	1993	1994	1995	1991–1995
Estimates for pending legislation:						
House Passed:						
Money Laundering Enforcement Amendments (H.R. 26):						
OMB estimate	0	0	0	0	0	0
CBO estimate	—	—	—	—	—	—
Transfer of Pershing Hall to the Department of Veterans Affairs (H.R. 154):						
OMB estimate	1	0	0	0	0	1
CBO estimate	0	0	0	0	0	0
Reclamation Projects Authorization (H.R. 429):						
OMB estimate	0 to 3	1 to 51	2 to 12	2 to 12	2 to 12	7 to 90
CBO estimate	0	–7	–9	–8	–8	–32
Veterans' Compensation Programs Improvement Act (H.R. 1047):						
OMB estimate	* to 1	2 to 5	2 to 5	2 to 5	2 to 5	8 to 21
CBO estimate	*	5	5	5	5	20
National Flood Insurance (H.R. 1236):						
OMB estimate	0	0	–3	–7	–1	–11
CBO estimate	0	0	–3	–7	–1	–11
National Defense Authorization Act (H.R. 2100):						
OMB estimate	revised estimate under development					
CBO estimate	0	–10	–20	–20	–20	–70
Senate Passed:						
Telecommunications Research and Manufacturing Competition Act (S. 173):						
OMB estimate	0	0	0	0	0	0
CBO estimate	—	—	—	—	—	—
Export Administration Authorization Act (S. 320):						
OMB estimate	—	–6	–6	–6	–6	–24
CBO estimate	—	—	—	—	—	—
Passed both the House and the Senate:						
Futures Trading Practices Act (H.R. 707):						
House: OMB estimate	—	—	—	—	—	—
CBO estimate	—	—	—	—	—	—
Senate: OMB estimate	0	–3	–6	–11	–16	–36
CBO estimate	0	–3	–6	–10	–14	–33
Intelligence Authorization (H.R. 1455):						
OMB estimate	*	*	*	*	*	1
CBO estimate	*	*	*	*	*	1
Total, preliminary estimates for pending legislation as of July 7:						
OMB estimate	1 to 5	–6 to 47	–11 to 2	–20 to –7	–19 to –6	–54 to 42
CBO estimate	*	–5	–13	–20	–18	–55
OMB estimate less CBO estimate [2]	1 to 5	–1 to 52	2 to 15	0 to 13	–1 to 12	1 to 97

[1] No legislation was enacted between June 14th, the date of the last pay-as-you-go monthly report to the Congress and July 7th.

[2] Reflects Senate version of H.R. 707, and excludes H.R. 2100.

*$500,000 or less.

TABLE 11: CURRENT STATUS OF DISCRETIONARY SPENDING LIMITS

(In millions of dollars)

	1991 Budget		1992 Budget	
	Authority	Outlays	Authority	Outlays
Domestic Programs:				
Limits set in Omnibus Budget Reconciliation Act of 1990	182,700	198,100	191,300	210,100
Adjustments made in the preview report [1]	191	1,763	7,100	970
Preview report limits	182,891	199,863	198,400	211,070
Adjustments for Congressional action to date:				
Dire emergency appropriations	39	187	—	3
Incremental costs of Operation Desert Shield/Desert Storm	5	4	126	125
Additional outlay allowance used	—	416	—	—
Adjustments in expectation of enactment of President's proposals:				
IRS funding	—	—	172	169
Special allowance	—	—	1,579	837
Revised limits	182,935	200,470	200,277	212,204
International Programs:				
Limits set in Omnibus Budget Reconciliation Act of 1990	20,100	18,600	20,500	19,100
Adjustments made in the preview report [1]	0	612	417	77
Preview report limits	20,100	19,212	20,917	19,177
Adjustments for Congressional action to date:				
Dire emergency appropriations	909	899	—	8
Incremental costs of Operation Desert Shield/Desert Storm	236	133	—	72
Additional outlay allowance used	—	53	—	—
Adjustments in expectation of enactment of President's proposals:				
IMF funding	—	—	12,158	—
Special allowance	—	—	1,248	574
Revised limits	21,245	20,296	34,323	19,830
Defense Programs:				
Limits set in Omnibus Budget Reconciliation Act of 1990	288,918	297,660	291,643	295,744
Adjustments made in the preview report [1]	1,000	1,165	−282	46
Preview report limits	289,918	298,825	291,361	295,790
Adjustments for Congressional action to date:				
Incremental costs of Operation Desert Shield/Desert Storm	43,000	31,977	—	6,705
Adjustments in expectation of enactment of President's proposals:				
Incremental costs of Operation Desert Shield/Desert Storm	2,949	−5,291	—	5,442
Revised limits	335,867	325,511	291,361	307,937

[1] See Fiscal Year 1992 Budget, Part 5, Chapter XIV for a discussion of these adjustments.

IV. APPENDICES

APPENDIX A: IMPROVING MEDICAID ESTIMATES: REPORT OF HHS–OMB TASK FORCE, JULY 10, 1991

APPENDIX B: UNITED STATES COSTS IN THE PERSIAN GULF CONFLICT AND FOREIGN CONTRIBUTIONS TO OFFSET SUCH COSTS; REPORT #5: JULY 15, 1991

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IMPROVING MEDICAID ESTIMATES: REPORT OF HHS-OMB TASK FORCE

On April 30, 1991, Health and Human Services (HHS) Secretary Louis Sullivan and Office of Management and Budget (OMB) Director Richard Darman established a special HHS-OMB Management Review Task Force. The purpose of the Review was to address continuing and largely unanticipated increases in Medicaid spending.

A set of four fact-finding teams (jointly staffed by HHS, OMB and the Health Care Financing Administration (HCFA)) were organized. Two teams, supplemented by staff from the Congressional Budget Office (CBO), visited nine States. The State visits were coordinated with the National Governors' Association (NGA), the National Association of State Budget Officers (NASBO), and the National Conference of State Legislators (NCSL).

The Teams:

- Analyzed why Medicaid estimates have been so inaccurate;
- Examined the deficiencies in the current Federal/State estimating process that allow such discrepancies to occur without prior notice, as well as possible corrective measures;
- Looked at ways to work more closely with the States to understand the unique policy dynamics of the program in each State; and
- Used the results of the review to improve Federal Medicaid tracking efforts and to evaluate better the fiscal impact of future Medicaid policy changes.

The Task Force also commissioned an independent actuary to review the accuracy of Medicaid estimates.

This report draws on the reports of these Teams. Despite the short review time, the Team reports provide useful findings, analyses and insights. The Team reports are available from OMB or HCFA.

A. BACKGROUND

The Medicaid program assists States in financing health care for 27 million low-income and medically needy people. States are required to provide a minimum benefit package (e.g., hospital and physician services), but may elect to cover additional benefits (e.g., drugs and dental care). Medicaid has changed greatly over the past decade. It now provides a widespread health care safety net, much broader than the original purpose of financing health care to welfare recipients.

Begun in 1965, Medicaid will spend an estimated $115 billion in Federal and State funds in FY 1992. Medicaid now dwarfs all other Federal aid programs to State and local governments. The program is also becoming the largest single component of State budgets: NASBO predicts that 22 percent of State budgets in 1996 will be for Medicaid.

The Medicaid program is administered and jointly financed by the States and the Federal government. The Federal share of total program costs could range from 50 to 83 percent, depending on a State's per capita income.

Recently, there have been unanticipated increases in Medicaid costs. FY 1991 estimates rose $8.28 billion or 18 percent. FY 1992 estimates rose $8.4 billion or 14 percent. Charts 1A and 1B show the percentage increases in FY 1991 and 1992 estimates for the nine States visited by the teams. Chart 1C shows projected increases from FY 1990 through FY 1996.

B. PRINCIPAL FINDINGS

(1) Cost Increases

Federal expenditures for Medicaid increased threefold between 1980 and 1990, from $14 billion to $41 billion; these expenditures are now expected to increase another 59 percent to over $65 billion in 1992. (See Chart 2.)

The Task Force actuary estimated that most Medicaid spending increases (59 percent) over the 1980-90 time period were due primarily to health care inflation. Federal legislation and waiver programs accounted for 22 percent of the increase; other factors, such as intensity of service and State initiatives to increase Federal match, accounted for 15 percent; increased enrollment accounted for only four percent of the spending growth.

While the actual expenditures remain to be determined, most of the unexpected increases in Medicaid estimates for FY 1991 and 1992 appear to be due to:

- Substantial increases in inpatient hospital care, some of which are attributable to increases in payment rates made possible through provider tax and refundable donation programs. (These programs arrange for providers to pay specified taxes or make donations to a State to fund a part of the State's share of Medicaid funding — increasing the amount of Federal matching funds a State receives, and allowing states to increase their spending as well.)

- Increased numbers of beneficiaries, some of whom now receive benefits as a result of post-1985 Congressional expansions of eligibility for Medicaid.

- Starting in 1988, a generally unpredicted upturn in acute health care costs.

(2) Refinancing: Increasing State Reliance on Provider Taxes and Refundable Donations

Initiatives to increase the Federal match (e.g., provider tax and refundable donation programs) accounted for only a small portion of the Medicaid increase over the 1980-90 period. However, initiatives of this kind appear to be constituting a substantial portion of the increases in the 1991-92 estimates of those States which currently use these devices ($3-5 billion in each year). Recent information suggests dramatically increased reliance on these schemes to increase the effective Federal share of real State Medicaid costs.

States are working to maximize Federal payments and cover up to 100 percent of State costs by implementing provider tax and refundable donation provisions. They can do this by raising nominal provider payment rates while (i) effectively recapturing the increase (through provider taxes or refunded donations) and (ii) claiming higher Federal reimbursement on their "gross costs." Such practices are under intensive Federal legal scrutiny.

Since the Federal government currently reimburses the States based on gross costs, Federal reimbursements lower the real costs borne by the States. While the nominal Federal matching rate remains unchanged (on gross costs), the effective Federal share of real (net) Medicaid costs increases. By 1996, the aggregate effective Federal matching rate is estimated to rise to 62 percent under current rules — even though the nominal Federal matching rate is projected to remain about 57 percent (see Chart 3).

Congress has blocked regulations to constrain State reliance on provider taxes and refundable donations since 1988, currently extending the bar through 1991. The Medicaid Baseline assumes the promulgation of regulations to constrain the use of provider taxes and refundable donations beginning in 1992 (reducing their impact in that year by $1-3 billion). Legislation will be required to eliminate completely the use of these devices. Chart 4 shows the projected impact of such regulations and legislation.

(3) Estimates

State Estimates. The Federal estimates of Medicaid spending are based on State estimates.

— While the average overall error in State estimates over the ten year period 1980-90 was only -0.3 percent, State under-estimating errors have been increasing since 1989 (-9.2 percent in 1990; an expected -18.0 percent in 1991; and an expected -16.0 percent in 1992).

— There are also enormous differences in estimating accuracy among States. Nineteen States had estimating errors greater than 10 percent with respect to FY 1990; Alabama, Kansas, Arizona and Massachusetts had estimating errors of over 20 percent. While most of the largest States had estimating errors under 5 percent (California, New York, Texas) for FY 1990, these States accounted for an aggregate estimating error of $2.1 billion for FY 1991 (27 percent for Texas, 17 percent for New York and 7 percent for California).

Federal Estimates. Federal adjustments to State estimates 1980-90 (including management and regulatory initiatives) increased the average error from -0.3 percent to -2.8 percent. While Federal adjustments in this period tended to improve estimates on the average when State estimating errors were low, they tended to increase the error when the estimating errors were large (particularly since 1987 when States have underestimated actual expenditures). Until recent years, the Federal Government has tended toward lower forecasts than the States.

Different estimating methods are now used for current and budget year projections versus outyear projections. Use of State estimates in HCFA out-year projections can compound mis-estimates.

Overall. The general conclusion is that inaccuracies in Medicaid estimates are primarily associated with changes in trends. While these are always difficult to forecast, providing a higher priority and capability for Medicaid estimating, at both the Federal and State levels, would significantly improve the timeliness and accuracy of forecasts. This is essential if Federal and State policy and budgeting actions are to proceed in an orderly way.

As can be seen in Chart 5, a change in trend occurred in FY 1989. The current Federal estimate for FY 1992 Federal expenditures on Medicaid increased from $50 billion in January 1990 to $65 billion in July 1991 (a 30 percent increase in estimates, or $15 billion, in 18 months). If greater attention were paid to Medicaid estimating at both the Federal and State levels, much of this new trend should have been predictable much earlier than it was.

Task Force Team members visited nine Sates accounting for almost half of projected Medicaid spending for FY 1991 and 1992 (Alabama, California, Florida, Maryland, Massachusetts, New York, Ohio, Pennsylvania, and Texas). All nine of these States used provider taxes and refundable donations to help finance State costs and increase the Federal share.

Mis-estimates in these States appear to be due primarily to changes in Federal or State legislation and policies (including provider taxes and refundable donations) and Court decisions (about two-thirds of the increase). Only about one-third of the mis-estimates were attributable to problems in the States' estimating processes. Economic trends appear to play a lesser role. The most significant reasons for mis-estimates in these States were:

— An unpredicted increase, beginning in 1988, in health care inflation;

— Court cases, particularly "Boren Amendment" cases, that increase reimbursement rates for hospitals and nursing homes; and

— Significant growth in provider tax and refundable donation mechanisms (about one-quarter of the total increase in estimates in the States visited).

<u>N.B.</u> While only 27 States used provider tax and refundable donation mechanisms in 1990, it can be anticipated that virtually all States will likely move to use these mechanisms in the near future if they continue to be allowable.

(4) State Capabilities

States have access to a great deal of information on Medicaid costs. But State capabilities to tap and analyze this information vary widely.

— Some States have well qualified personnel and employ sophisticated estimating models; others do not.

— States that link Medicaid estimating to their State budget processes appear to produce more accurate estimates than those that do not.

— Many States do not take reporting to the Federal Government on HCFA Form 25 seriously, and thus do not provide accurate, complete or timely estimates.

— Many States do not provide the Federal Government with the assumptions used in

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making estimates. No distinction is made between baseline estimates and new program estimates.

— Technical problems include differences in fiscal years and State use of accrued versus cash budgeting.

(5) Federal Capabilities

There is no single entity responsible for Federal Medicaid estimating. HCFA Regional Offices, the Medicaid Bureau, the HCFA Medicaid actuary, the HCFA Office of Budget and Administration, the HHS Assistant Secretary for Management and Budget and OMB are all involved, but currently no single entity is accountable and no full actuarial analysis is made at the Federal level.

Other problems include:

— Both the Medicaid Bureau and the HCFA Actuary lack sufficient qualified professional staff — both to stay on top of new State program developments and to provide professional judgments on the accuracy of State estimates.

— HCFA lacks detailed information on current State rules regarding eligibility, reimbursement and coverage.

— Medicaid State Plans and other useful information are often kept at HCFA Regional Offices and not transmitted to the HCFA Central Office. Regional Office staff are not trained in forecasting, and are thus not able to analyze State estimates technically.

— Although HCFA surveys the States quarterly, State responses are voluntary and HCFA lacks precise knowledge of whether estimates of the impacts of recent Federal legislation have been accurately included in State estimates.

— The HCFA Form 25 contains little useful information on why States expect growth in program expenditures; the explanatory section of the Form is frequently not completed, or completed superficially. Only a small amount of the information collected quarterly from the States on the Form is actually used for estimating or policy analysis purposes. The Form is incapable of capturing the volatile aspects of Medicaid that now drive increases in Federal expenditures; nor does it capture the reasons for the changes.

— HCFA provides little guidance, oversight or feedback regarding State estimating of Medicaid costs. Some States have indicated they didn't know that HCFA cared about the accuracy of State estimates.

C. PRINCIPAL RECOMMENDATIONS

Management Recommendations

While a program as large, as varied, and as dynamic as Medicaid will always have estimating errors, structurally much can be done to improve the accuracy of both Federal and State estimates. Better estimates, however, have as much to do with a commitment to improve Medicaid estimating as with projection methodologies or other technical issues.

Four management recommendations and one policy recommendation follow:

(1) Medicaid Bureau Responsibility

The HCFA Medicaid Bureau (MB) should have full Federal responsibility and accountability for managing the Medicaid program.

— The MB should be in direct contact with the States to ensure that HCFA has early knowledge of proposed and actual State program and estimating changes.

— The MB should provide the HCFA Actuary with the policy assumptions lying behind program change estimates, based on its assessment of which changes are likely to go into effect. The HCFA Actuary should critically appraise State estimates, the adequacy of information obtained by the MB, and the impacts of Federal and State program changes. The Actuary should recommend to the MB Federal adjustments to the State estimates.

— The MB should have sufficient qualified staff to provide for professionally qualified desk officers for major States and groups of smaller States.

— The Medicaid Actuary should have sufficient qualified staff to enable it to provide critical appraisals of State estimates and recommend adjustments thereto.

(2) Improved Federal and State Estimates

State Program Information. The Medicaid Bureau should begin to maintain, make available to the public, and possibly automate:

— State-by-State inventories of baseline Medicaid program features and proposed program changes. By October 31, 1991.

— Detailed extracts of State Plans and amendments, describing State eligibility, coverage and reimbursement policies (distinguishing mandatory and optional features). By October 31, 1991.

— Listings of potential Medicaid policy changes that will have budget impacts (e.g., State or Federal policy changes under consideration, including any allowable provider tax and refundable donation mechanisms, expected reimbursement rate changes, and law suits that might result in changed expenditures). By December 31, 1991.

— Specific, regularly updated reports on the status of Medicaid legislation in each State legislature. By December 31, 1991.

The MB should continuously track (between the submission of quarterly State estimates) State administrative, legislative and judicial changes with a budgetary impact.

State Estimates. The Medicaid Bureau should by October 31, 1991, maintain for the 10 largest States separate State-by-State estimates of (i) current service spending and (ii) costs of anticipated Federal and State policy and program changes. The MB should have this system in place for all states by March 31, 1992. MB should work with the States to provide:

— State baseline estimates of expenditures (assuming no policy changes).

— Listings of assumptions underlying these baseline estimates on eligibility, coverage, reimbursement, and any other key factors.

— Listings of expected changes to baseline estimates.

Consideration should be given to automating this process.

HCFA Forecasting System. HCFA should initiate immediately the development of a Medicaid budget forecasting system that provides State-level estimates for at least key States. An estimating model should be in place by July 1992.

— Federal projections might be developed for larger State programs, as well as for States with a track record of unreliable estimates.

HCFA Reporting Forms. The MB should revise substantially its State budget estimate reporting form (HCFA-25). In addition, HCFA needs to improve its collections of data on actual Medicaid program expenditures; the current financial management report (HCFA-64) and statistical report (HCFA-2082) are not sufficiently timely or detailed to provide satisfactory support for historical program analysis or the development of accurate budget estimates. The revised forms should be available for use by February 1992.

— The MB should consult with the States and decide what information is critical and determine how best to get it.

— The goal should be to collect critical information and reduce unnecessary collections, so as to minimize burdens on the States.

(3) A new Partnership with the States

The Medicaid Bureau should provide systematic and ongoing feedback to States on the accuracy of State estimates and reinforce the importance of timely, complete and accurate estimates.

— HCFA should reward State officials who do a good job of estimating (e.g., public recognition, cash awards, and publication of exemplary State methodologies and charts detailing the accuracy of State budget estimates).

— HCFA should explore disincentives to discourage State estimates that are consistently late or exceed a specified error threshold.

— HCFA and the States should identify and disseminate "best practices" that States might use in producing more accurate estimates.

— HCFA, in conjunction with the States, should consider convening annual conferences of officials responsible for preparing Medicaid forecasts to exchange information on Medicaid estimates.

(4) Implementation

The MB should (a) within 30 days submit to the HCFA Administrator a detailed plan for implementation of the recommendations in the report and (b) report to the HCFA Administrator on September 30, 1991, and each quarter thereafter, on the progress in implementing the recommendations in the Report. The HCFA Administrator should forward these progress reports to the Secretary of HHS and the Director of OMB.

— HCFA should report quarterly on its progress to the States.

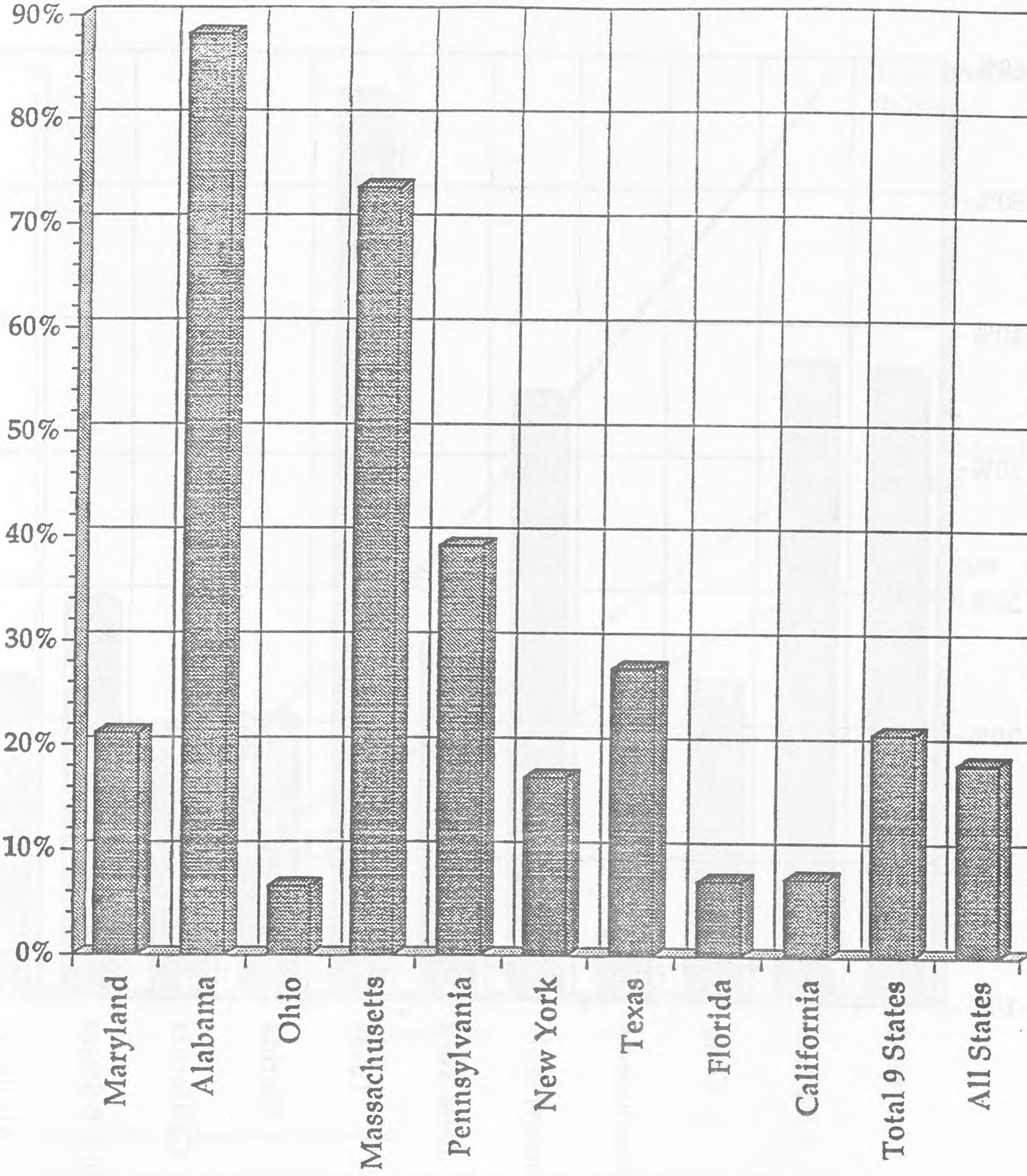
— HCFA should issue quarterly public reports on Medicaid expenditures and estimates.

<u>Policy Recommendation</u>

The Task Force recommends that the Administration and Congress proceed promptly with regulatory and legislative measures to restrict the use of provider tax and refundable donation programs that, if more widely used, will both stretch the Medicaid Program beyond its original intent and contribute to making Medicaid a health care program that is Federally financed to a much greater degree. If such actions are not taken, combined Federal and State program costs could exceed $200 billion by 1996. Escalating increases in Medicaid program costs will also make Medicaid larger than Medicare by 1995. (See Chart 6.)

— HCFA should develop by July 31 a package of regulatory and legislative reforms which would eliminate inappropriate use of provider taxes and refundable donations.

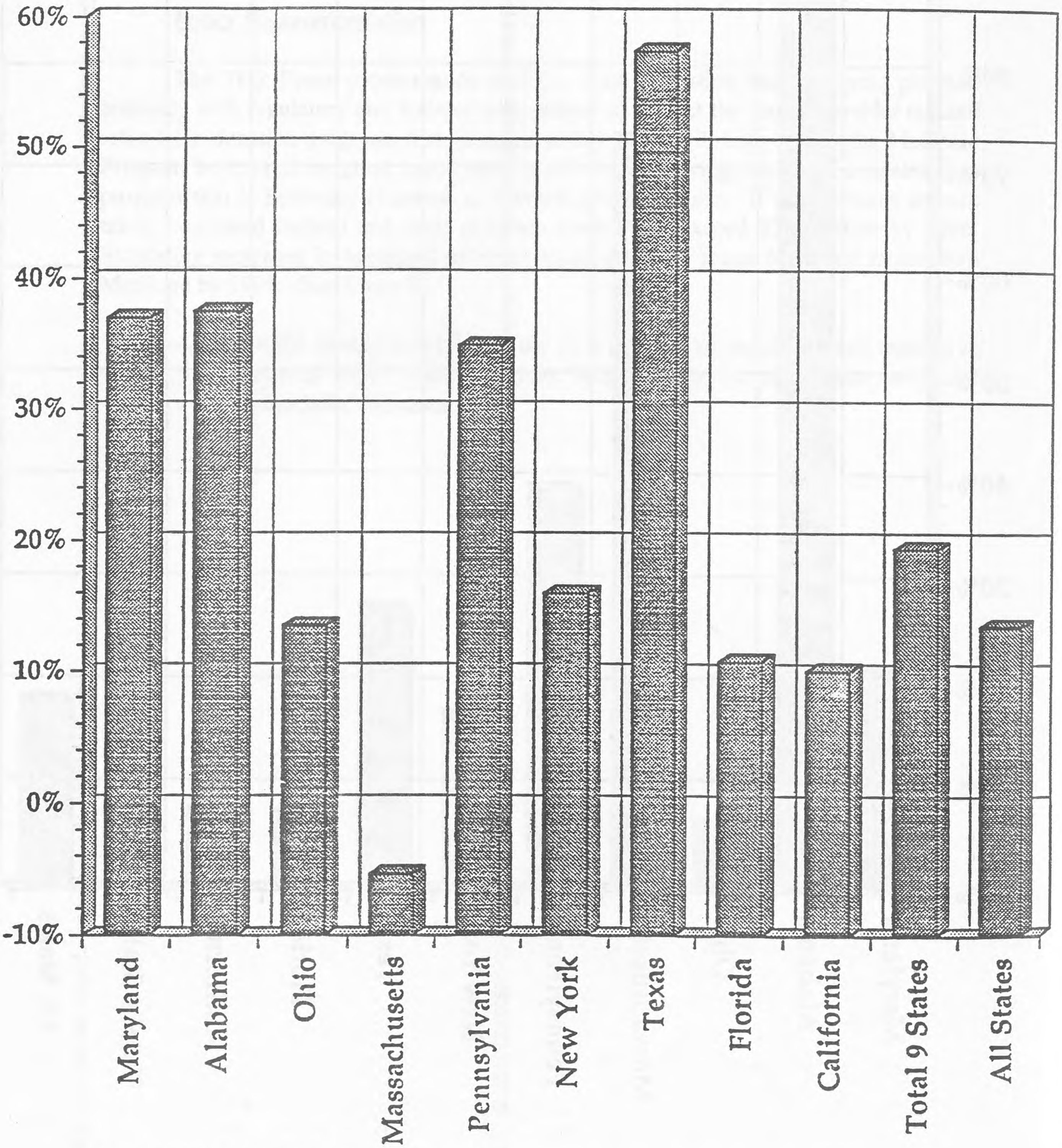
Chart 1A
Percent Increase in State Estimates for FY91 Federal Medicaid Expenditures



Source: Health Care Financing Administration

Note: Chart reflects percent differences between State estimates on 11/89 versus State estimates 5/91 for Fiscal Year 1991.

Chart 1B
Percent Increase in State Estimates For FY92 Federal Medicaid Expenditures



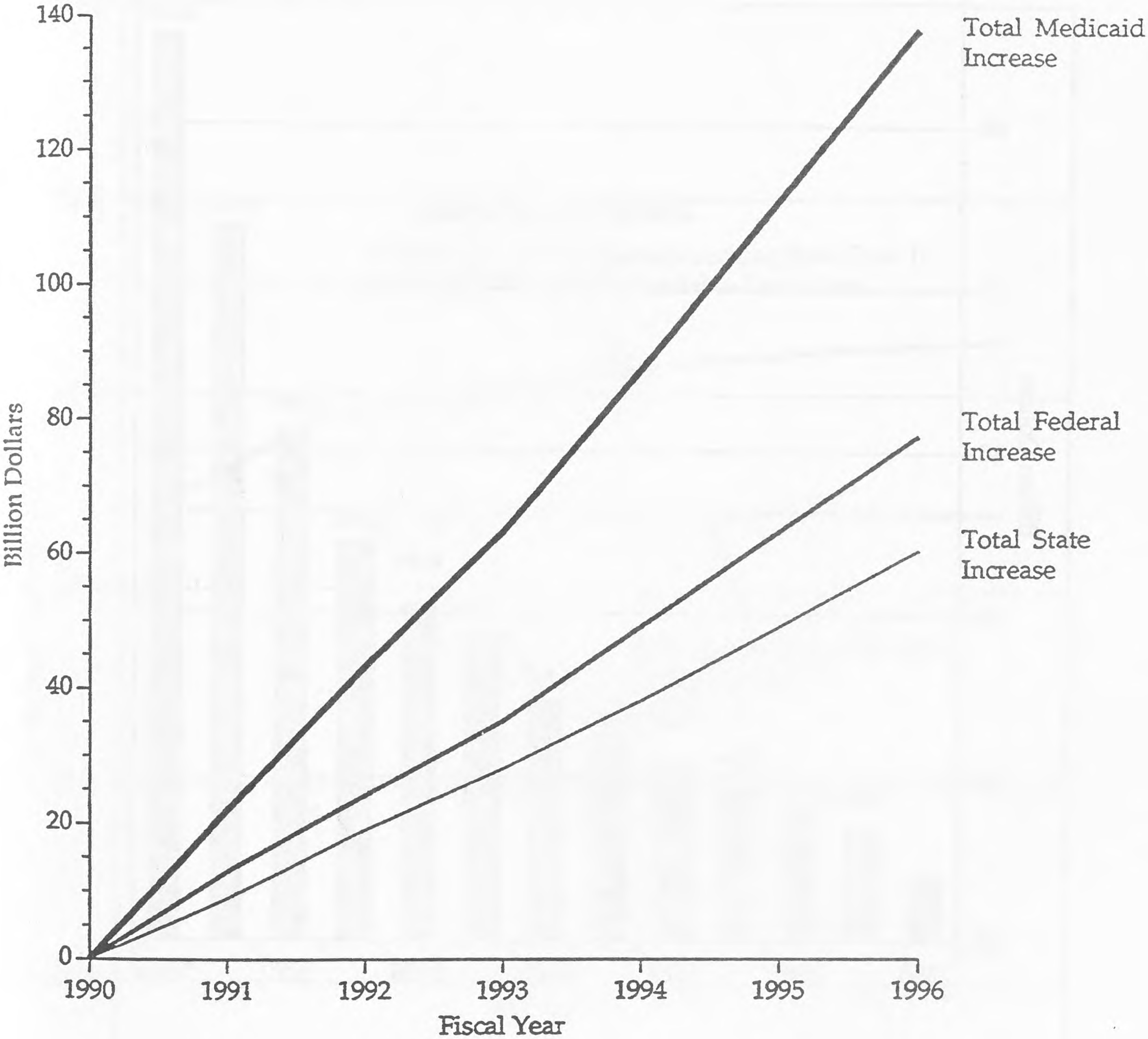
Source: Health Care Financing Administration

Note: Chart reflects percent differences between State estimates in 5/90 versus State estimates in 5/91 for Fiscal Year 1992.

Chart 1C

Increase in Total, Federal and State Medicaid Spending

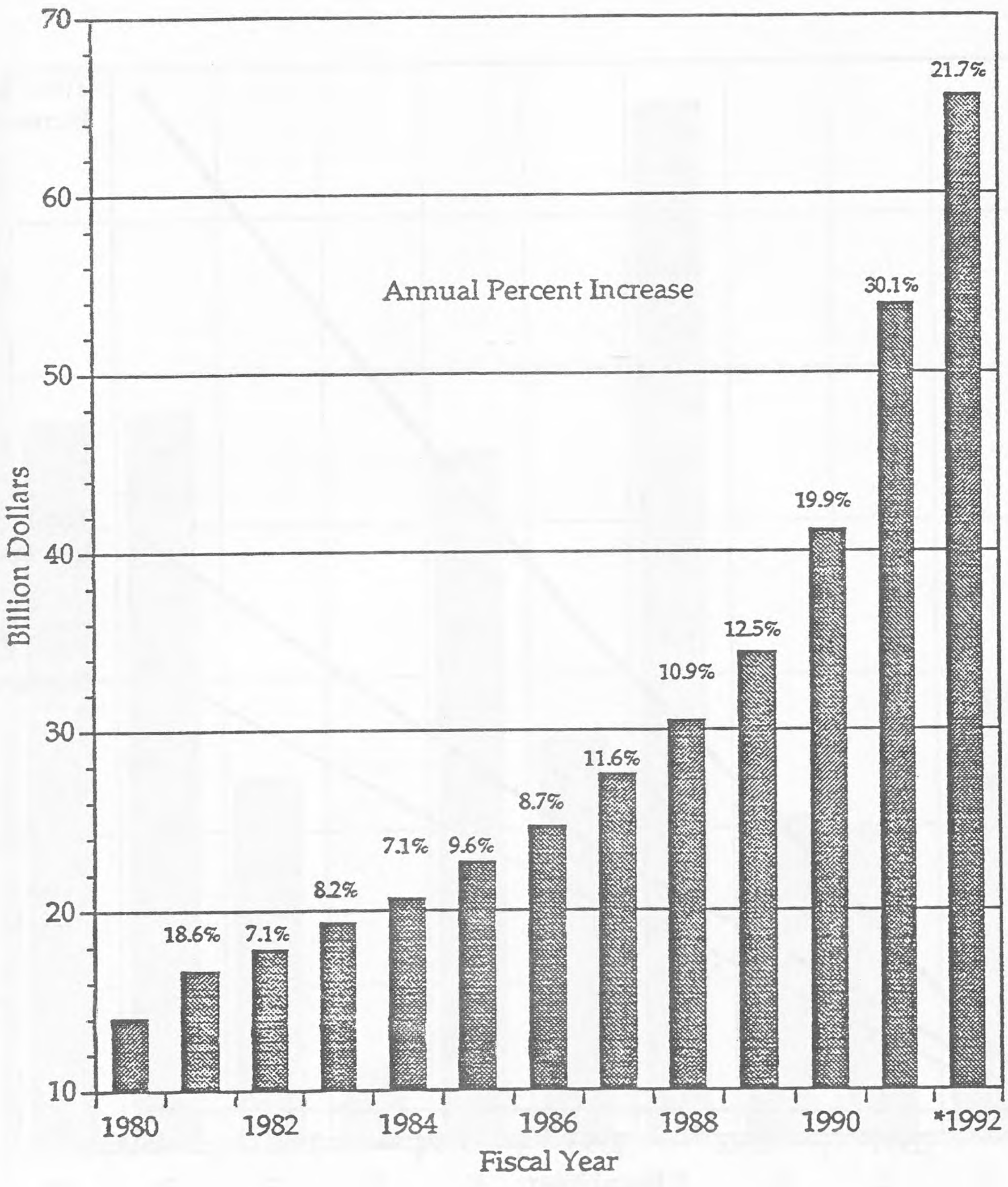
(estimated 1991 - 1996 increases over 1990 levels)



Source: Office of Management and Budget

Note: The FY 1990 levels from which the above totals increased were $72 billion for total Medicaid, $41 billion for total Federal Medicaid, and $31 billion for total State Medicaid spending.

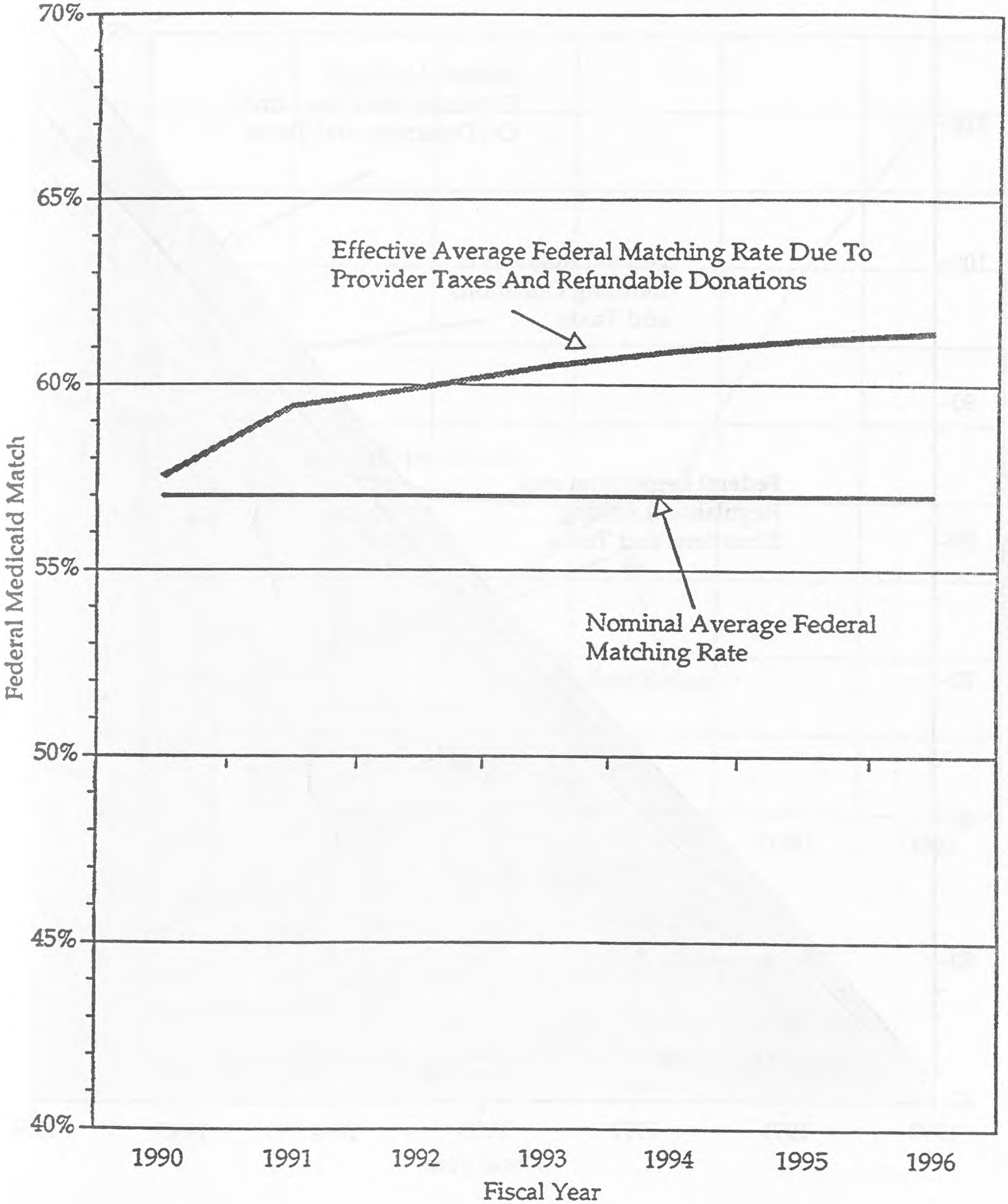
Chart 2
Federal Medicaid Outlays, 1980-1992



Source: HCFA Actuary

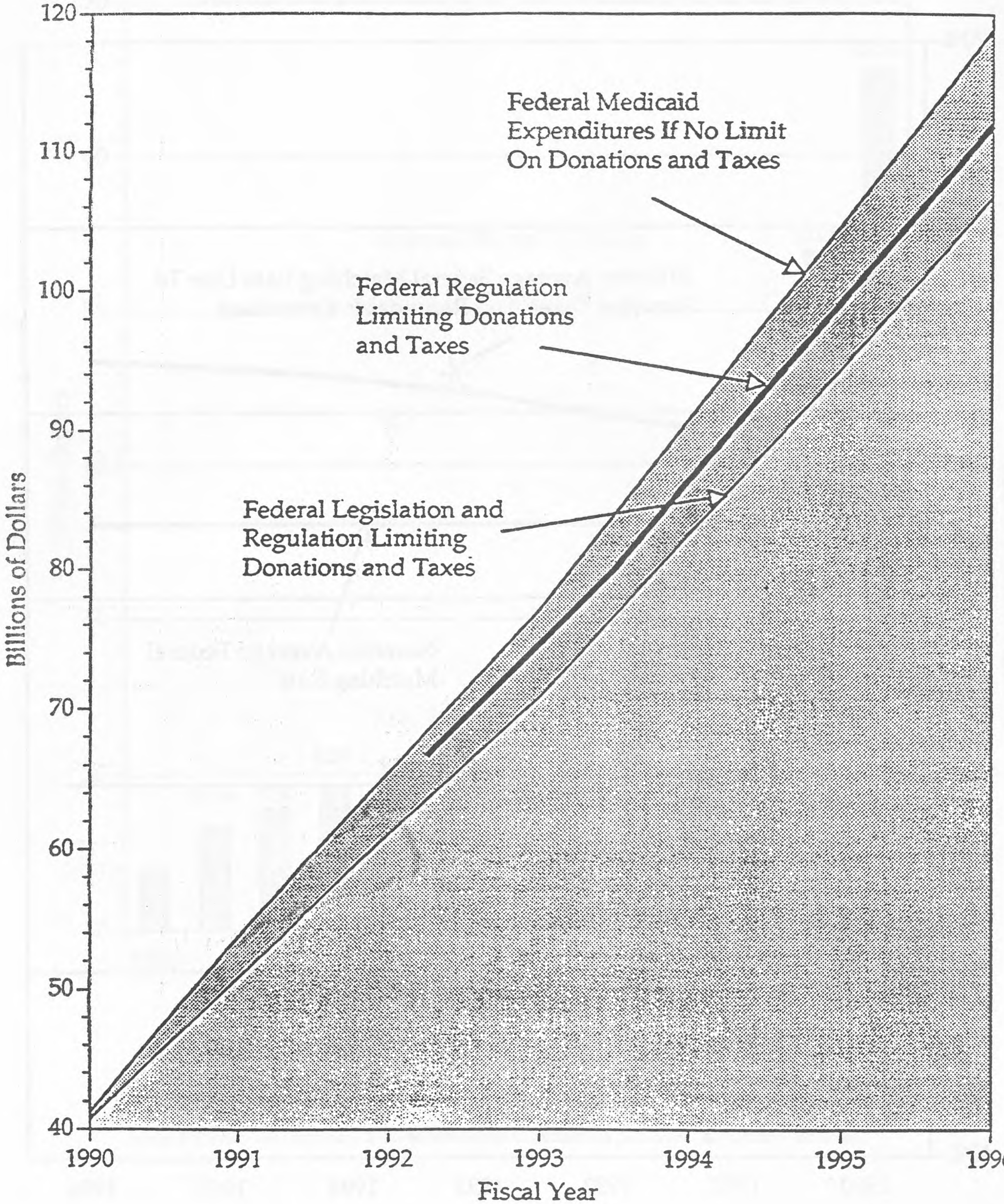
Note: FY 1991-1992 estimate if no action taken to constrain provider "donations" or taxes.

Chart 3
Provider Tax and Refundable Donation Schemes Increase The Effective Federal Medicaid Match



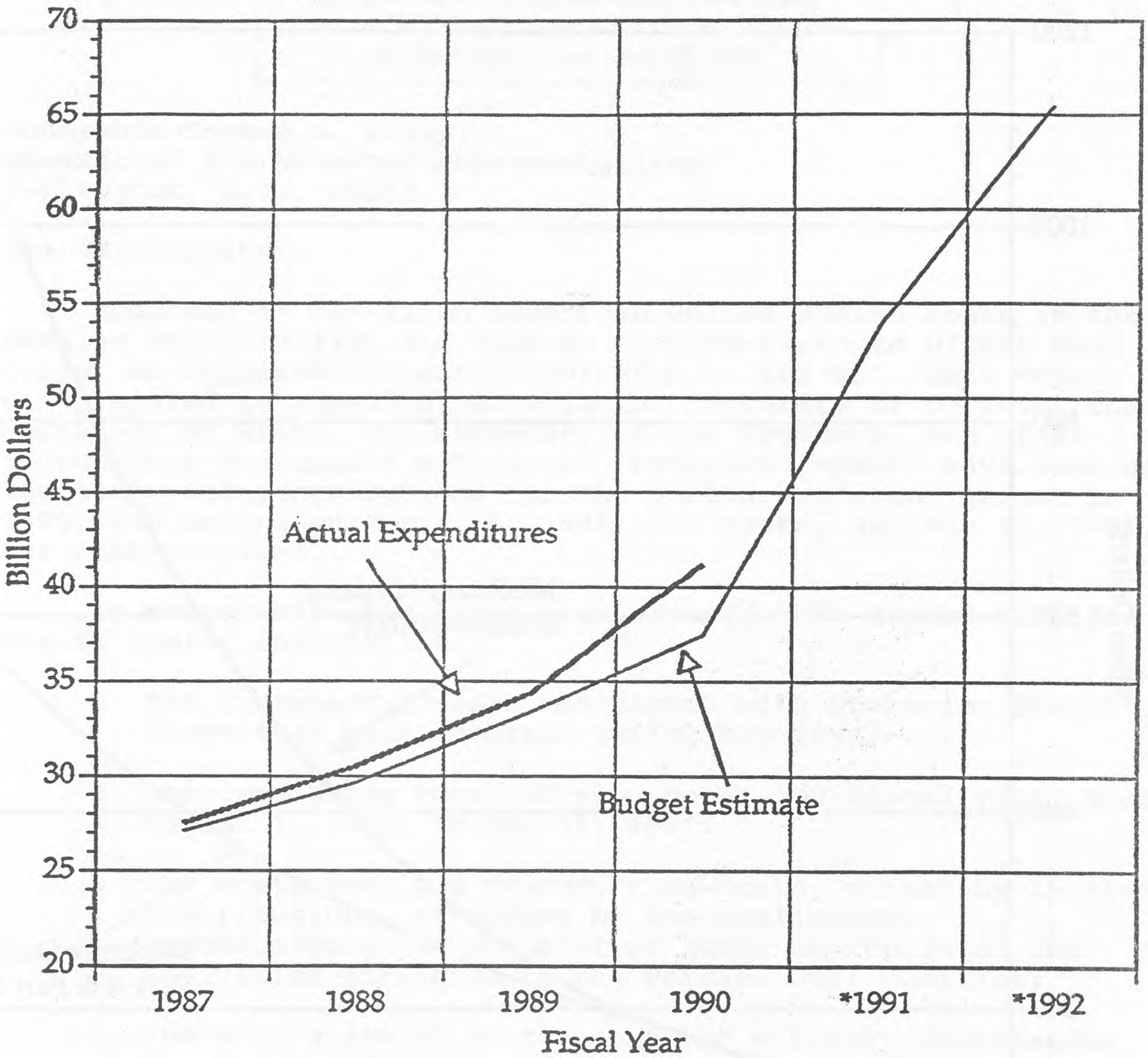
Source: Office of Management and Budget

Chart 4
Federal Medicaid Expenditures for Provider Tax and Refundable Donation Schemes



Source: HCFA Actuary
Note: FY91-96 estimated.

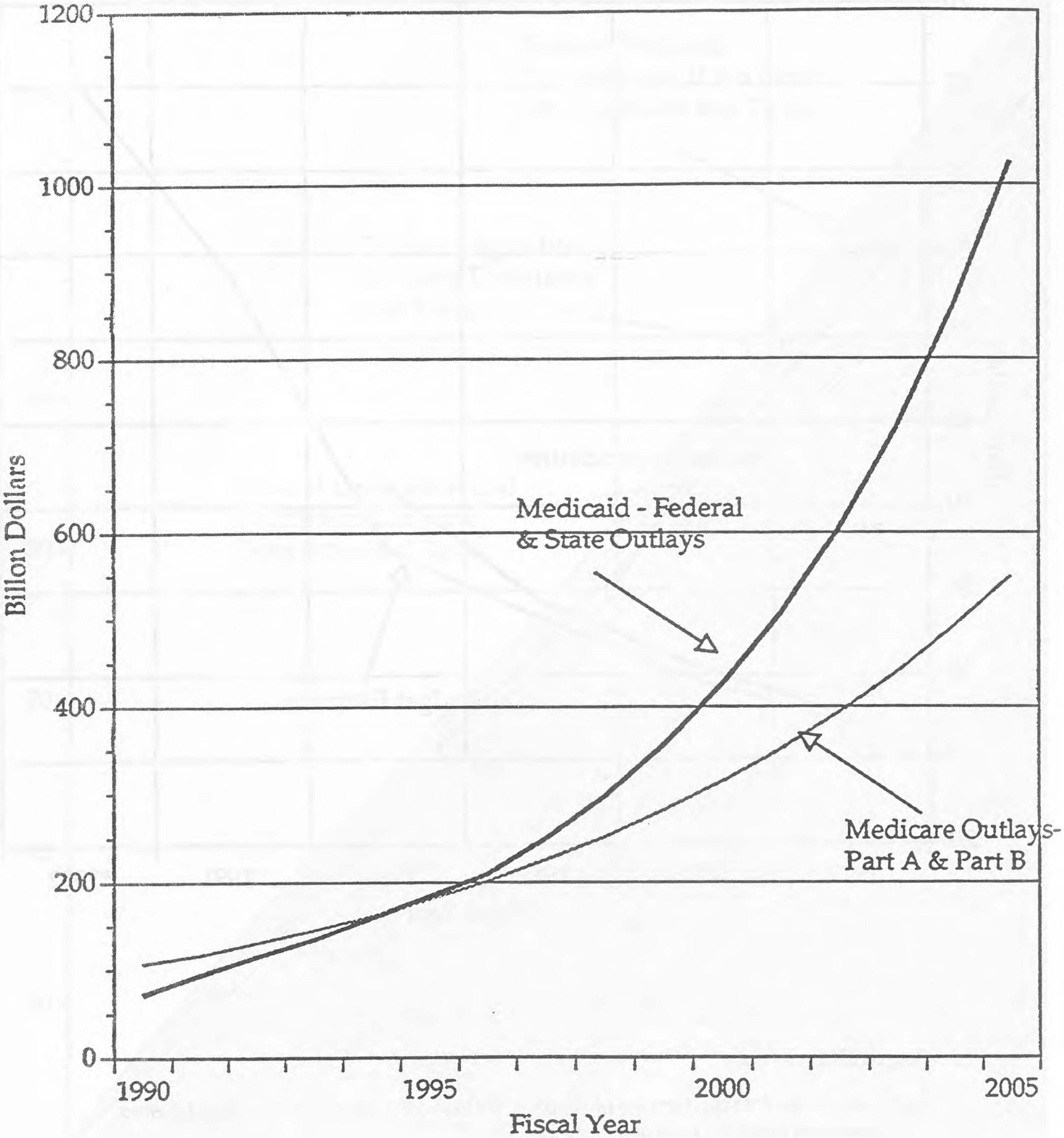
Chart 5
Estimated vs. Actual Federal Medicaid Outlays, 1987-1992



Source: HCFA Actuary

Note: Actuals for FY 1991-1992 are unavaiable. FY 1991-1992 estimate if no action taken to constrain provider "donations" or taxes.

Chart 6
Trends Project Medicaid Soon Will Be Larger Than Medicare



Source: OMB

Note: FY 1997-2005 projections reflect average growth FY 1990-1996

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

THE DIRECTOR

The following is the text of the letter transmitting the fifth report on United States Costs in the Persian Gulf Conflict and Foreign Contributions to Offset Such Costs; July 15, 1991

July 15, 1991

Honorable Thomas S. Foley
Speaker of the House of Representatives
Washington, D.C. 20515

Dear Mr. Speaker:

Enclosed is the fifth report on United States Costs in the Persian Gulf Conflict and Foreign Contributions to Offset Such Costs, as required by Section 401 of P.L. 102-25. This report was prepared in consultation with the Secretary of Defense, the Secretary of State, the Secretary of the Treasury, and other appropriate government officials. Previous reports have covered the costs and contributions for the period beginning August 1, 1990, and ending on April 30, 1991, for costs, and May 31, 1991, for contributions.

In accord with the legal requirement, this report provides the following information:

- the incremental costs associated with Operation Desert Storm that were incurred during May 1991;

- the cumulative total of such costs, by fiscal year, from August 1, 1990, to May 31, 1991;

- the costs that are nonrecurring costs, offset by in-kind contributions, or offset by the realignment, reprogramming, or transfer of funds appropriated for activities unrelated to the Persian Gulf conflict;

- the allocation of costs among the military departments, the Defense Agencies of the Department of Defense, and the Office of the Secretary of Defense by category -- airlift, sealift, personnel, personnel support, operating support, fuel, procurement, and military construction; and

- the amount of contributions made to the United States by each foreign country during June 1991, as well as the cumulative total of such contributions. The report specifies the amount of cash payments pledged and received, provides a description and value of in-kind contributions pledged and received, and identifies restrictions on the use of such contributions.

The costs reported to this point should be viewed as partial and preliminary for reasons noted in the enclosure. As required by Section 401 of P.L. 102-25, a sixth report will be submitted by August 15th. In accord with the legal requirement, it will cover incremental costs associated with Operation Desert Storm that were incurred in June 1991, and foreign contributions for July 1991. Subsequent reports will be submitted by the 15th day of each month, as required, and will revise preliminary reports to reflect additional cost estimates or reestimates.

Respectfully yours,

Richard Darman
Director

Enclosure

IDENTICAL LETTER SENT TO HONORABLE J. DANFORTH QUAYLE

COPIES TO: HONORABLE ROBERT C. BYRD, HONORABLE MARK O. HATFIELD, HONORABLE JAMIE L. WHITTEN, HONORABLE JOSEPH M. MCDADE, HONORABLE DANIEL K. INOUYE, HONORABLE TED STEVENS, HONORABLE JOHN P. MURTHA, HONORABLE SAM NUNN, HONORABLE JOHN W. WARNER, HONORABLE LES ASPIN, HONORABLE WILLIAM L. DICKINSON, HONORABLE JIM SASSER, HONORABLE PETE V. DOMENICI, HONORABLE LEON E. PANETTA, AND HONORABLE WILLIS D. GRADISON, JR.

UNITED STATES COSTS IN THE PERSIAN GULF CONFLICT AND FOREIGN CONTRIBUTIONS TO OFFSET SUCH COSTS

Report #5: July 15, 1991

Section 401 of P.L. 102-25 requires a series of reports on incremental costs associated with Operation Desert Storm and on foreign contributions to offset such costs. This is the fifth of such reports. As required by Section 401 of P.L. 102-25, it covers costs incurred during May 1991 and contributions made during June 1991. Previous reports have covered the costs and contributions for the period beginning August 1, 1990, and ending on April 30, 1991, for costs and May 31, 1991, for contributions.

Costs

The costs covered in this and subsequent reports are full incremental costs of Operation Desert Storm. These are additional costs resulting directly from the Persian Gulf crisis (i.e., costs that would not otherwise have been incurred). It should be noted that only a portion of full incremental costs are included in Defense supplemental appropriations. These portions are costs that require financing in fiscal year 1991 or fiscal year 1992 and that are exempt from statutory Defense budget ceilings. Not included in fiscal year 1991 or fiscal year 1992 appropriations are items of full incremental costs such as August - September 1990 costs and costs covered by in-kind contributions from allies.

Table 1 summarizes preliminary estimates of Department of Defense full incremental costs associated with Operation Desert Storm from August 1, 1990, through May 31, 1991. The cost information is shown by the cost and financing categories specified in Section 401 of P.L. 102-25. Tables 2-9 provide more detailed information by cost category. Costs shown in this report were developed by the Department of Defense and are based on the most recent data available.

Through May 1991, costs of $42.2 billion were reported by the Department of Defense. The costs reported so far are preliminary. This report includes an estimate of costs identified to date of equipment repair, rehabilitation, and maintenance caused by the high operating rates and combat use. The report also includes some of the costs of phasedown of operations and the return home of the deployed forces.

There are substantial costs that have not yet been reported. These include equipment repair, rehabilitation, and restoration that have not so far been identified, long-term benefit and disability costs, and the costs of continuing operations in the region. About 68,000 military personnel were in the region at the end of May, and approximately 72,000 reservists were still on active duty at that time. Significant amounts of materiel, equipment, ammunition and vehicles had not been shipped from Southwest Asia at the end of May. Materiel still in theater includes the large, heavy pieces of equipment which are costly and time consuming to prepare and transport. Combat aircraft continue to fly in the region and the U.S. forces will continue to remain in the region until all parties are satisfied with long term security arrangements. The costs through May plus the other costs not yet reported are expected by the Department of Defense to result in total incremental costs of over $61 billion.

Incremental Coast Guard costs of $3 million were incurred during this reporting period, with cumulative costs of $26 million through May to support military operations in the Persian Gulf.

Contributions

Section 401 of P.L. 102-25 requires that this report include the amount of each country's contribution during the period covered by the report, as well as the cumulative total of such contributions. Cash and in-kind contributions pledged and received are to be specified.

Tables 10 and 11 list foreign contributions pledged in 1990 and 1991, respectively, and amounts received in June. Cash and in-kind contributions are separately specified.

As of July 12, 1991, foreign countries contributed $8.0 billion of the $9.7 billion pledged in calendar year 1990, and $36.5 billion of the $44.2 billion pledged in calendar year 1991. Of the total $44.5 billion received, $39.1 billion was in cash and $5.4 billion was in-kind assistance (including food, fuel, water, building materials, transportation, and support equipment). Table 12 provides further detail on in-kind contributions.

Table 13 summarizes the current status of commitments and contributions received through July 12, 1991.

Future Reports

As required by Section 401 of P.L. 102-25, the next report will be submitted by August 15th. In accord with the legal requirement, it will cover incremental costs associated with Operation Desert Storm that were incurred in June 1991, and foreign contributions for July 1991. Subsequent reports will be submitted by the 15th day of each month, as required, and will revise preliminary reports to reflect additional costs as they are estimated or re-estimated.

List of Tables

Table 1

SUMMARY 1/

INCREMENTAL COSTS ASSOCIATED WITH OPERATION DESERT STORM

Incurred by the Department of Defense
From August 1, 1990 Through May 31, 1991
($ in millions)
Preliminary Estimates

	FY 1990	FY 1991			Partial and Preliminary
	Aug – Sep	Oct – Apr	This period May	Total through May	Aug 1990 – May 1991
(1) Airlift	412	1,725	378	2,103	2,515
(2) Sealift	235	2,314	662	2,976	3,212
(3) Personnel	223	3,937	632	4,569	4,792
(4) Personnel Support	352	4,822	178	5,000	5,352
(5) Operating Support	1,210	11,680	278	11,958	13,168
(6) Fuel	626	3,263	372	3,635	4,261
(7) Procurement	129	8,272	68	8,339	8,468
(8) Military Construction	11	415		415	426
Total	3,197	36,429	2,567	38,996	42,194 2/

Nonrecurring costs included above 3/	201	11,855	662	12,516	12,718
Costs offset by:					
In-kind contributions	225	4,886	188	5,073	5,298
Realignment 4/	913	59		59	972

1/ Data was compiled by OMB. Source of data -- Department of Defense. This report adjusts earlier estimates to reflect more complete accounting information.

2/ The costs reported so far are preliminary. This report includes an estimate of costs identified to date of equipment repair, rehabilitation, and maintenance caused by the high operating rates and combat use. Additional costs for these categories will be reported as more information becomes available. The report also includes some of the costs of phasedown of operations and the return home of the deployed forces. However, certain long-term benefit and disability costs have not been reflected in the estimates. Those costs will be reported in later reports. The costs through May plus the other costs not yet reported are expected by the Department of Defense to result in total incremental costs of slightly more than $61 billion.

3/ Nonrecurring costs include investment costs associated with procurement and Military Construction, as well as other one-time costs such as the activation of the Ready Reserve Force ships.

4/ This includes the realignment, reprogramming, or transfer of funds appropriated for activities unrelated to the Persian Gulf conflict.

Table 2

AIRLIFT

INCREMENTAL COSTS ASSOCIATED WITH OPERATION DESERT STORM
Incurred by the Department of Defense
From August 1, 1990 Through May 31, 1991
($ in millions)
Preliminary Estimates

	FY 1990	FY 1991			Partial and Preliminary
	Aug – Sep	Oct – Apr	This period May	Total through May	Aug 1990 – May 1991
Airlift					
Army	207	646	278	924	1,131
Navy	85	585	84	668	754
Air Force	114	470	10	480	595
Intelligence Agencies		1		1	1
Special Operations Command	6	24	7	30	36
Total	412	1,725	378	2,103	2,515

Nonrecurring costs included above		583	270	853	853
Costs offset by:					
In-kind contributions	7	78	10	88	96
Realignment 2/	6				6

1/ This includes the realignment, reprogramming, or transfer of funds appropriated for activities unrelated to the Persian Gulf conflict.

This category includes costs related to the transportation by air of personnel, equipment and supplies.

During this period over 1,300 redeployment missions were flown, returning over 104,000 people and 39,000 short tons of cargo to the U.S. and Europe. In addition, over 1,100 other missions were flown to carry supplies to U.S. forces still in the region.

Table 3

SEALIFT

INCREMENTAL COSTS ASSOCIATED WITH OPERATION DESERT STORM
Incurred by the Department of Defense
From August 1, 1990 Through May 31, 1991
($ in millions)
Preliminary Estimates

	FY 1990	FY 1991			Partial and Preliminary
	Aug – Sep	Oct – Apr	This period May	Total through May	Aug 1990 – May 1991
Sealift					
Army	123	1,767	574	2,340	2,463
Navy	99	337	45	382	481
Air Force	12	194	42	236	248
Defense Logistics Agency		14	2	16	16
Special Operations Command	2	2		2	4
Total	235	2,314	662	2,976	3,212

Nonrecurring costs included above	57	694	229	924	981
Costs offset by:					
In-kind contributions	2	121	6	127	129
Realignment 1/	2				2

1/ This includes the realignment, reprogramming, or transfer of funds appropriated for activities unrelated to the Persian Gulf conflict.

This category includes costs related to the transportation by sea of personnel, equipment and supplies.

The previous October-April estimate has been reduced by $765 million, of which $442 million has been shifted to the operating support category. The balance represents refinement of previous estimates.

During this period a total of 64 ships (25 of them foreign flag ships) made redeployment deliveries. These vessels shipped over 282,000 short tons of dry cargo back to the U.S. and Europe. In addition, 170,000 short tons of petroleum products were transported to sustain U.S. forces still in the region.

Table 4

PERSONNEL

INCREMENTAL COSTS ASSOCIATED WITH OPERATION DESERT STORM
Incurred by the Department of Defense
From August 1, 1990 Through May 31, 1991
($ in millions)
Preliminary Estimates

	FY 1990 Aug - Sep	FY 1991 Oct - Apr	This period May	Total through May	Partial and Preliminary Aug 1990 - May 1991
Personnel					
Army	126	2,374	333	2,707	2,833
Navy	22	826	163	989	1,011
Air Force	75	737	136	873	948
Total	223	3,937	632	4,569	4,792

Nonrecurring costs included above		45		45	45
Costs offset by:					
In-kind contributions					
Realignment 1/	15				15

1/ This includes the realignment, reprogramming, or transfer of funds appropriated for activities unrelated to the Persian Gulf conflict.

This category includes pay and allowances of members of the reserve components of the Armed Forces called or ordered to active duty and the increased pay and allowances of members of the regular components of the Armed Forces incurred because of deployment in connection with Operation Desert Storm.

The previous October-April estimate has been reduced by $74 million in additional savings in Reserve component accounts.

At the end of May about 72,000 Reservists were still on active duty and about 68,000 people were still in theater.

Table 5

PERSONNEL SUPPORT

INCREMENTAL COSTS ASSOCIATED WITH OPERATION DESERT STORM
Incurred by the Department of Defense
From August 1, 1990 Through May 31, 1991
($ in millions)
Preliminary Estimates

	FY 1990	FY 1991			Partial and Preliminary
	Aug – Sep	Oct – Apr	This period May	Total through May	Aug 1990 – May 1991
Personnel Support					
Army	209	3,621	136	3,757	3,966
Navy	104	772	35	807	911
Air Force	24	386	6	392	415
Intelligence Agencies	2	9	1	9	11
Defense Logistics Agency	12	15	0 1/	15	27
Defense Mapping Agency		4	0 1/	4	4
Special Operations Command	2	7	0 1/	8	9
Office of the Secretary of Defense		9	0 1/	9	9
Total	352	4,822	178	5,000	5,352

Nonrecurring costs included above	4	994	44	1,038	1,042
Costs offset by:					
In-kind contributions	28	1,487	87	1,574	1,601
Realignment 2/	3				3

1/ Costs are less than $500 thousand.

2/ This includes the realignment, reprogramming, or transfer of funds appropriated for activities unrelated to the Persian Gulf conflict.

This category includes subsistence, uniforms and medical costs.

The previous October-April estimate has been increased by $108 million primarily to account for CHAMPUS costs.

In May, major costs were for subsistence and medical support.

Table 6

OPERATING SUPPORT

INCREMENTAL COSTS ASSOCIATED WITH OPERATION DESERT STORM
Incurred by the Department of Defense
From August 1, 1990 Through May 31, 1991
($ in millions)
Preliminary Estimates

	FY 1990	FY 1991			Partial and Preliminary
	Aug – Sep	Oct – Apr	This period May	Total through May	Aug 1990 – May 1991
Operating Support					
Army	896	6,493	72	6,565	7,461
Navy	223	3,179	27	3,205	3,428
Air Force	68	1,930	177	2,107	2,175
Intelligence Agencies		1		1	1
Special Operations Command	15	26		26	41
Defense Communications Agency		1		1	1
Defense Mapping Agency	8	46	1	47	55
Defense Nuclear Agency		2		2	2
Office of the Secretary of Defense		3		3	3
Total	1,210	11,680	278	11,958	13,168

Nonrecurring costs included above		852	51	903	903
Costs offset by:					
In-kind contributions	167	1,576	23	1,598	1,765
Realignment 2/	698	12		12	710

1/ This includes the realignment, reprogramming, or transfer of funds appropriated for activities unrelated to the Persian Gulf conflict.

This category includes equipment support costs, costs associated with increased operational tempo, spare parts, stock fund purchases, communications, and equipment maintenance.

The previous October–April estimate has been increased by $226 million. This increase is the net effect of changes in the category in which costs are reported. Repair, rehabilitation, and maintenance costs of sealift assets are now reported under operating support while certain incremental in-country fuel costs previously reported in this category are now reported under the fuel category.

Costs reported during this period were primarily equipment maintenance and in-country operating costs.

Table 7

FUEL

INCREMENTAL COSTS ASSOCIATED WITH OPERATION DESERT STORM
Incurred by the Department of Defense
From August 1, 1990 Through May 31, 1991
($ in millions)
Preliminary Estimates

	FY 1990	FY 1991			Partial and Preliminary
	Aug – Sep	Oct – Apr	This period May	Total through May	Aug 1990 – May 1991
Fuel					
Army	10	115	5	121	130
Navy	19	1,135	95	1,230	1,249
Air Force	137	2,005	270	2,275	2,412
Special Operations Command		8	1	9	9
Defense Logistics Agency	460				460
Total	626	3,263	372	3,635	4,261

Nonrecurring costs included above					
Costs offset by:					
In-kind contributions	21	1,072	62	1,135	1,156
Realignment 1/	60				60

1/ This includes the realignment, reprogramming, or transfer of funds appropriated for activities unrelated to the Persian Gulf conflict.

This category includes the additional fuel required for higher operating tempo and for airlift and sealift transportation of personnel and equipment as well as for the higher prices for fuel during the period.

Costs reported during this period were about equally divided between higher operating tempo and higher prices.

Table 8

PROCUREMENT

INCREMENTAL COSTS ASSOCIATED WITH OPERATION DESERT STORM
Incurred by the Department of Defense
From August 1, 1990 Through May 31, 1991
($ in millions)
Preliminary Estimates

	FY 1990 Aug - Sep	FY 1991 Oct - Apr	This period May	Total through May	Partial and Preliminary Aug 1990 - May 1991
Procurement					
Army	49	2,307	10	2,318	2,367
Navy	47	2,503		2,503	2,550
Air Force	32	3,324	57	3,381	3,413
Intelligence Agencies	1	13		13	13
Defense Communications Agency		0		0	0 1/
Special Operations Command		99		99	99
Defense Logistics Agency		4		4	4
Defense Mapping Agency		1		1	1
Defense Nuclear Agency		0		0	0 1/
Defense Systems Project Office		1		1	1
Office of the Secretary of Defense		21		21	21
Total	129	8,272	68	8,339	8,468

Nonrecurring costs included above	129	8,272	68	8,339	8,468
Costs offset by:					
In-kind contributions		155		155	155
Realignment 2/	119	47		47	165

1/ Costs are less than $500 thousand.
2/ This includes the realignment, reprogramming, or transfer of funds appropriated for activities unrelated to the Persian Gulf conflict.

This category includes ammunition, weapon systems improvements and upgrades, and equipment purchases.

The previous October-April estimates has been increased by $29 million to reflect refinement of costs for special purpose equipment to facilitate operations in Southwest Asia and a revision of costs for Army vehicle losses. Costs for May primarily reflect replacement of components on Air Force F-117 aircraft.

Table 9

MILITARY CONSTRUCTION

INCREMENTAL COSTS ASSOCIATED WITH OPERATION DESERT STORM
Incurred by the Department of Defense
From August 1, 1990 Through May 31, 1991
($ in millions)
Preliminary Estimates

	FY 1990	FY 1991			Partial and Preliminary
	Aug - Sep	Oct - Apr	This period May	Total through May	Aug 1990 - May 1991
Military Construction					
Army	7	414		414	421
Navy					
Air Force	4	2		2	5
Total	11	415		415	426
Nonrecurring costs included above	11	415		415	426
Costs offset by:					
In-kind contributions		397		397	397
Realignment 2/	11				11

1/ Costs are less than $500 thousand.
2/ This includes the realignment, reprogramming, or transfer of funds appropriated for activities unrelated to the Persian Gulf conflict.

This category includes the cost of constructing temporary billets for troops, and administrative and supply and maintenance facilities.

There were no new costs reported in this category. There was a small decrease in the previously reported October-April costs due to a reestimate of certain in-kind costs by CENTCOM.

Table 10

FOREIGN CONTRIBUTIONS PLEDGED IN 1990 TO OFFSET U.S. COSTS 1/
($ in millions)

	Commitments			Receipts in June			Receipts through July 12, 1991			Future Receipts
	Cash	In-kind	Total	Cash	In-kind	Total	Cash	In-kind	Total	
GCC STATES	5,861	984	6,845				4,256	984	5,240	1,605
SAUDI ARABIA	2,474	865	3,339				886	865	1,751	1,588 2/
KUWAIT	2,500	6	2,506				2,500	6	2,506	
UAE	887	113	1,000				870	113	983	17 3/
GERMANY 4/	260	812	1,072				272	782	1,054	18 5/
JAPAN 4/	961	779	1,740		—		961	637	1,598	142 6/
KOREA	50	30	80				50	30	80	
BAHRAIN		1	1					1	1	
OMAN/QATAR		1	1					1	1	
DENMARK		1	1					1	1	
TOTAL	7,132	2,608	9,740				5,539	2,436	7,975	1,765

1/ Data was compiled by OMB. Sources of data: commitments -- Defense, State, and Treasury; cash received -- Treasury; receipts and value of in-kind assistance -- Defense.

2/ This is reimbursement for enroute transportation through December for the second deployment and for U.S. in-theater expenses for food, building materials, fuel, and support. Bills for reimbursement have been forwarded to Saudi Arabia.

3/ This is undergoing a final accounting.

4/ 1990 cash contributions were for transportation and associated costs.

5/ An accounting of in-kind assistance accepted by U.S. forces is under way.

6/ Resolution of balance is under discussion and should be resolved shortly.

Table 11

FOREIGN CONTRIBUTIONS PLEDGED IN 1991 TO OFFSET U.S. COSTS 1/
($ in millions)

	Commitments 2/			Receipts in June			Receipts through July 12, 1991			Future Receipts
	Cash	In-kind	Total	Cash	In-kind	Total	Cash	In-kind	Total	
GCC STATES	27,146	2,941	30,087	700	178	878	19,575	2,941	22,516	7,571
SAUDI ARABIA	10,672	2,828	13,500		168	168	7,300	2,828	10,128	3,372
KUWAIT	13,474	26	13,500	700	8	708	9,275	26	9,301	4,199
UAE	3,000	87	3,087		2	2	3,000	87	3,087	
GERMANY	5,500		5,500				5,500		5,500	
JAPAN 3/	8,332 4/		8,332				8,332		8,332	
KOREA	100	175	275 5/	40	4	44	100	40	140	136 5/
DENMARK		6	6					6	6	
LUXEMBOURG		6	6					6	6	
OTHER	4	2	6		1	1	4	2	6	
TOTAL	41,082	3,130	44,212	740	183	921	33,511	2,994	36,505	7,707

1/ Data was compiled by OMB. Sources of data: commitments -- Defense, State, and Treasury; cash received -- Treasury; receipts and value of in-kind assistance -- Defense.

2/ 1991 commitments in most instances did not distinguish between cash and in-kind. The commitment shown above reflects actual in-kind assistance received unless specific information is available.

3/ 1991 cash contributions are for logistics and related support.

4/ The previously reported commitment has been reduced by $668 million, which has been paid to other coalition partners. A difference of understanding arose with respect to the Japanese contribution for 1991. On July 11th the President met with Prime Minister Kaifu and concluded that the difference in understanding was reasonable and Japan's payments were made in good faith with the agreed commitment. The President thereupon stated that "any differences that might have existed . . . have been resolved."

5/ The previously reported commitment has been corrected by a reduction of $30 million, which Korea paid to the U.K. The revision reflects an understanding between the United States and the Government of Korea that the terms of the Korean commitment allow this $30 million contribution to other members of the multinational forces. Future receipts are for in-kind assistance consisting of replenishment stocks for which delivery is now being arranged and transportation assistance, which is being drawn down as needed by U.S. forces.

Table 12

DESCRIPTION OF IN-KIND ASSISTANCE RECEIVED
TO OFFSET U.S. COSTS AS OF JUNE 30, 1991
($ in millions)

	Calendar Year 1990	Calendar Year 1991
SAUDI ARABIA ...... Host nation support including food, fuel, housing, building materials, transportation and port handling services.	865	2,828
KUWAIT ...... Transportation	6	26
UNITED ARAB EMIRATES ...... Fuel, food and water, security services, construction equipment and civilian labor.	113	87
GERMANY ...... Vehicles including cargo trucks, water trailers, buses and ambulances; generators; radios; portable showers; protective masks, and chemical sensing vehicles	782	
JAPAN ...... Construction and engineering support, vehicles, electronic data processing, telephone services, medical equipment, and transportation.	637	
KOREA ...... Transportation	30	40
BAHRAIN ...... Medical supplies, food and water	1	
OMAN/QATAR ...... Oil, telephones, food and water	1	
DENMARK ...... Transportation	1	6
LUXEMBOURG...... Transportation		6
OTHER ...... Transportation		2
TOTAL	2,436	2,994

Table 13

FOREIGN CONTRIBUTIONS PLEDGED IN 1990 AND 1991 TO OFFSET U.S. COSTS
COMMITMENTS AND RECEIPTS THROUGH JULY 12, 1991 1/
($ in millions)

	Commitments			Receipts 2/			Future Receipts
	1990	1991	Total	Cash	In-kind	Total	
GCC STATES	6,845	30,087	36,932	23,831	3,925	27,756	9,176
SAUDI ARABIA	3,339	13,500	16,839	8,186	3,693	11,879	4,960
KUWAIT	2,506	13,500	16,006	11,775	32	11,807	4,199
UAE	1,000	3,087	4,087	3,870	200	4,070	17 3/
GERMANY	1,072	5,500	6,572	5,772	782	6,554	18 4/
JAPAN	1,740	8,332	10,072	9,293	637	9,930	142
KOREA	80	275	355	150	70	220	136
OTHER	3	18	21	4	17	21	
TOTAL	9,740	44,212	53,952	39,050	5,431	44,481	9,471

1/ Data was compiled by OMB. Sources of data: commitments -- Defense, State, and Treasury; cash received -- Treasury; receipts and value of in-kind assistance -- Defense.

2/ Cash receipts are as of July 12, 1991. In-kind assistance is as of June 30, 1991.

3/ This is undergoing a final accounting.

4/ An accounting of in-kind assistance accepted by U.S. forces is under way.

Table 1: MID-SESSION REVIEW: OUTLAYS FOR MANDATORY AND RELATED PROGRAMS UNDER CURRENT LAW

(In billions of dollars)

	1991	1992	1993	1994	1995	1996
Mandatory programs:						
Human resources programs:						
Education, training, employment, and social services	12.1	13.1	13.1	12.0	11.6	7.6
Health	56.6	69.5	81.7	96.6	110.9	126.2
Medicare	102.4	114.8	126.4	140.6	156.7	176.3
Income security	147.4	157.3	163.8	173.6	181.7	188.8
Social Security	266.2	284.0	301.3	318.3	335.7	353.6
Veterans benefits and services	17.8	18.5	19.0	20.9	19.8	18.7
Total, mandatory human resources programs	602.4	657.3	705.3	762.0	816.6	871.2
Other mandatory programs:						
International affairs	–1.4	–1.8	–2.2	–3.0	–3.3	–3.3
Energy	–1.8	–0.8	–0.6	–0.4	–1.3	–2.2
Agriculture	12.6	12.8	13.2	12.1	10.3	10.3
Commerce and housing credit	87.9	120.9	53.7	–21.7	–42.3	–35.6
Justice	0.3	0.2	0.3	0.3	0.3	1.0
General government	0.2	1.5	1.0	0.7	0.8	1.1
Other functions	0.3	0.1	–0.1	–0.4	–0.3	–0.3
Total, other mandatory programs	98.2	132.9	65.2	–12.5	–35.7	–29.1
Total, mandatory programs	700.6	790.1	770.5	749.6	780.8	842.1
Net interest	194.9	205.0	220.7	231.2	237.9	244.4
Undistributed offsetting receipts	–39.0	–39.1	–40.9	–42.6	–43.9	–45.6
Total, outlays for mandatory and related programs under current law	856.5	956.1	950.3	938.2	974.8	1,040.9

Table 2: MID-SESSION REVIEW: ESTIMATED SPENDING FROM END OF 1992 BALANCES OF BUDGET AUTHORITY: NONMANDATORY PROGRAMS

(In billions of dollars)

	Total
Total balances, end of 1992	619.1
Spending from 1992 balances in:	
1993	236.8
1994	123.4
1995	78.4
1996	54.5
Expiring balances, 1993 through 1996	—
Unexpended balances at the end of 1996	126.0

Table 3: MID-SESSION REVIEW: RECEIPTS BY MAJOR SOURCE

(In billions of dollars)

	Actual 1990	February Estimates						Current Estimates					
		1991	1992	1993	1994	1995	1996	1991	1992	1993	1994	1995	1996
Individual income taxes	466.9	492.6	529.5	572.0	632.9	688.9	742.1	481.9	518.2	560.5	612.3	659.1	707.0
Corporation income taxes	93.5	95.9	101.9	109.0	120.6	130.0	138.3	98.5	98.7	104.9	114.6	123.7	133.4
Social insurance taxes and contributions	380.0	402.0	429.4	463.8	501.0	534.1	568.5	395.1	427.2	461.3	497.4	530.3	564.9
On-budget	(98.4)	(103.7)	(114.1)	(125.1)	(135.5)	(144.2)	(151.3)	(102.1)	(113.7)	(124.0)	(134.6)	(143.3)	(150.5)
Off-budget	(281.7)	(298.3)	(315.3)	(338.7)	(365.5)	(389.8)	(417.2)	(293.0)	(313.5)	(337.3)	(362.8)	(387.0)	(414.4)
Excise taxes	35.3	44.8	47.8	50.1	52.0	53.6	47.8	42.3	46.6	49.1	50.8	52.2	46.4
Estate and gift taxes	11.5	12.2	13.3	14.1	13.7	14.6	15.7	11.5	12.5	13.6	13.5	14.6	15.8
Customs duties and fees	16.7	17.7	19.3	20.8	22.0	22.7	23.9	17.0	18.7	20.8	22.4	23.7	24.9
Miscellaneous receipts	27.3	26.2	23.9	22.8	23.2	23.5	24.5	22.4	23.6	23.0	23.3	23.6	24.6
Total, receipts	1,031.3	1,091.4	1,165.0	1,252.7	1,365.3	1,467.3	1,560.7	1,068.7	1,145.5	1,233.3	1,334.3	1,427.1	1,517.0
ADDENDUM													
On-budget	(749.7)	(793.2)	(849.8)	(914.0)	(999.8)	(1,077.5)	(1,143.5)	(775.7)	(832.0)	(895.9)	(971.5)	(1,040.1)	(1,102.6)
Off-budget	(281.7)	(298.3)	(315.3)	(338.7)	(365.5)	(389.8)	(417.2)	(293.0)	(313.5)	(337.3)	(362.8)	(387.0)	(414.4)

Table 4: MID-SESSION REVIEW: OUTLAYS BY CATEGORY

(In billions of dollars)

	Actual 1990	February Estimates						Current Estimates					
		1991	1992	1993	1994	1995	1996	1991	1992	1993	1994	1995	1996
Discretionary:													
Defense [1]	300.1	322.8	300.4	293.3	287.6	289.2	293.8	322.5	312.1	296.0	288.9	289.9	294.2
International	18.3	18.7	19.6	20.4	21.5	21.8	22.0	19.8	19.7	20.5	21.5	21.8	22.0
Domestic	182.5	199.8	212.0	223.2	228.9	231.7	238.5	200.5	212.4	223.4	228.8	231.7	238.4
Subtotal, discretionary	500.8	541.3	532.1	536.9	538.0	542.7	554.2	542.8	544.2	539.9	539.2	543.4	554.5
Mandatory	603.4	725.8	747.1	746.7	713.8	755.8	819.7	700.5	783.5	760.9	740.1	769.3	830.5
Asset sales and prepayments	–0.1	–0.5	–0.1	–*	–*	–*	–*	–0.5	–0.1	–*	–*	–*	–*
Foreign contributions for Desert Shield/Desert Storm	—	–15.0	—	—	—	—	—	–48.2	—	—	—	—	—
Net interest	184.2	197.0	206.3	212.0	215.5	213.8	211.0	195.3	205.6	219.3	226.9	229.5	230.9
Other undistributed offsetting receipts	–36.6	–39.1	–39.5	–41.4	–40.2	–42.0	–44.0	–39.0	–39.3	–41.2	–39.8	–41.4	–43.3
Total, outlays	1,251.7	1,409.6	1,445.9	1,454.2	1,427.1	1,470.3	1,540.8	1,350.9	1,493.8	1,478.9	1,466.4	1,500.7	1,572.5
ADDENDUM													
Budget authority for discretionary programs:													
Defense [1]	303.9	315.1	291.4	291.5	292.5	295.7	298.3	332.3	291.3	291.4	292.5	295.7	298.3
International	20.0	20.1	34.0	22.6	22.1	22.3	22.7	21.3	34.0	22.6	22.1	22.3	22.7
Domestic	170.2	188.1	197.4	201.5	202.7	205.5	214.0	188.6	197.4	201.6	202.7	205.5	214.0
Total, discretionary budget authority	494.2	523.4	522.7	515.6	517.3	523.6	535.0	542.2	522.8	515.7	517.3	523.6	535.0

[1] February estimates include Desert Shield/Desert Storm placeholder.

Table 5: MID-SESSION REVIEW: OUTLAYS BY FUNCTION

(In billions of dollars)

	Actual 1990	February Estimates						Current Estimates					
		1991	1992	1993	1994	1995	1996	1991	1992	1993	1994	1995	1996
National defense	299.3	298.9	295.2	292.0	286.7	288.6	293.2	273.6	311.5	295.4	288.3	289.3	293.6
Defense—Military	(289.8)	(287.5)	(283.0)	(279.1)	(273.3)	(274.6)	(278.5)	(262.2)	(299.3)	(282.6)	(274.9)	(275.3)	(278.9)
Other	(9.6)	(11.5)	(12.2)	(12.8)	(13.4)	(14.0)	(14.7)	(11.5)	(12.2)	(12.8)	(13.4)	(14.0)	(14.7)
International affairs	13.8	17.0	17.8	18.3	18.5	18.5	18.6	18.0	17.9	18.3	18.5	18.5	18.6
General science, space, and technology	14.4	15.8	17.5	19.1	20.9	22.4	23.9	15.8	17.4	19.1	20.9	22.4	23.9
Energy	2.4	2.6	3.7	4.8	5.0	4.0	3.4	2.6	3.7	4.8	5.0	4.0	3.4
Natural resources and environment	17.1	18.8	19.5	20.0	20.1	19.6	18.9	18.9	19.6	20.0	20.1	19.6	18.9
Agriculture	12.0	15.9	15.3	14.2	13.5	12.1	12.6	15.7	16.0	16.4	15.3	13.5	13.8
Commerce and housing credit	67.1	119.5	92.8	50.4	–32.8	–37.7	–26.8	91.5	122.7	55.2	–20.1	–40.5	–34.3
On-budget	(65.5)	(119.4)	(93.9)	(49.4)	(–33.5)	(–38.1)	(–26.1)	(91.5)	(123.8)	(54.2)	(–20.8)	(–41.0)	(–33.6)
Off-budget	(1.6)	(0.1)	(–1.1)	(1.0)	(0.7)	(0.5)	(–0.7)	(0.1)	(–1.1)	(1.0)	(0.7)	(0.5)	(–0.7)
Transportation	29.5	31.5	32.7	34.7	35.4	35.5	37.1	31.5	32.8	34.7	35.4	35.5	37.1
Community and regional development	8.5	7.7	6.5	5.9	5.6	5.5	5.4	8.0	6.7	6.1	5.6	5.5	5.4
Education, training, employment and social services	38.5	42.8	45.5	46.0	45.1	45.0	40.9	42.6	45.4	46.0	45.1	45.0	40.9
Health	57.7	71.2	81.3	91.3	102.0	112.9	125.2	73.4	86.9	99.9	115.0	129.6	144.9
Medicare	98.1	104.4	113.7	124.6	138.5	154.5	174.6	104.9	114.3	124.7	137.8	153.0	171.8
Income security	147.3	173.2	184.8	194.1	204.8	215.2	223.7	174.0	186.3	194.8	206.4	216.3	224.5
Social security	248.6	269.0	288.6	306.5	323.1	339.6	356.6	268.5	286.6	303.9	321.1	338.4	356.2
On-budget	(3.6)	(5.1)	(5.8)	(6.3)	(6.7)	(7.2)	(7.7)	(5.2)	(5.8)	(6.2)	(6.7)	(7.1)	(7.6)
Off-budget	(245.0)	(263.8)	(282.8)	(300.2)	(316.4)	(332.5)	(348.9)	(263.3)	(280.8)	(297.7)	(314.4)	(331.3)	(348.6)
Veterans benefits and services	29.1	31.5	33.0	33.9	36.6	36.1	35.7	31.8	33.2	34.1	36.4	36.0	35.6
Administration of justice	10.0	12.6	14.5	15.2	15.4	15.8	17.1	12.6	14.5	15.2	15.4	15.8	17.1
General government	10.7	11.2	13.2	14.1	14.2	13.4	14.2	11.3	13.2	14.1	14.2	13.4	14.2
Net interest	184.2	197.0	206.3	212.0	215.5	213.8	211.0	195.3	205.6	219.3	226.9	229.5	230.9
On-budget	(200.2)	(217.2)	(230.1)	(240.1)	(248.2)	(252.1)	(255.6)	(215.9)	(229.5)	(247.9)	(260.4)	(268.4)	(276.0)
Off-budget	(–16.0)	(–20.2)	(–23.7)	(–28.0)	(–32.8)	(–38.3)	(–44.6)	(–20.7)	(–23.9)	(–28.6)	(–33.5)	(–39.0)	(–45.1)
Allowances:													
Proposed agency contributions for PHS retirement	—	—	0.1	0.1	0.1	0.1	0.1	—	0.1	0.1	0.1	0.1	0.1
Desert Shield/Desert Storm placeholder [1]	—	8.2	4.6	0.8	0.4	—	—	—	—	—	—	—	—
Total, allowances	0.0	8.2	4.7	0.9	0.5	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Undistributed offsetting receipts	–36.6	–39.1	–40.8	–43.7	–41.4	–44.8	–44.9	–39.0	–40.6	–43.5	–41.0	–44.2	–44.2
On-budget	(–31.0)	(–33.3)	(–34.5)	(–36.9)	(–34.0)	(–36.6)	(–36.0)	(–33.2)	(–34.5)	(–36.9)	(–33.9)	(–36.5)	(–35.9)
Off-budget	(–5.6)	(–5.8)	(–6.2)	(–6.8)	(–7.4)	(–8.1)	(–8.9)	(–5.8)	(–6.1)	(–6.6)	(–7.1)	(–7.6)	(–8.3)
Total, outlays	1,251.7	1,409.6	1,445.9	1,454.2	1,427.1	1,470.3	1,540.8	1,350.9	1,493.8	1,478.9	1,466.4	1,500.7	1,572.5
ADDENDUM													
On-budget	1,026.6	1,171.7	1,194.2	1,187.8	1,150.2	1,183.8	1,246.1	1,114.0	1,244.1	1,215.3	1,191.9	1,215.6	1,278.0
Off-budget	225.1	237.9	251.7	266.4	276.8	286.5	294.7	236.9	249.7	263.6	274.5	285.2	294.5

[1] Current estimates allocate Desert Storm/Desert Shield spending and related foreign contributions by function.

Table 6: MID-SESSION REVIEW: FEDERAL GOVERNMENT FINANCING AND DEBT

(In billions of dollars)

	Actual 1990	Estimates					
		1990	1991	1992	1993	1994	1995
Financing:							
Surplus or deficit (–)	–220.4	–282.2	–348.3	–245.7	–132.1	–73.6	–55.5
(On-budget)	(–277.0)	(–338.3)	(–412.1)	(–318.5)	(–220.4)	(–175.4)	(–175.4)
(Off-budget)	(56.6)	(56.1)	(63.8)	(72.8)	(88.3)	(101.8)	(119.9)
Means of financing other than borrowing from the public:							
Decrease or increase (–) in Treasury operating cash balance	0.8	10.2	—	—	—	—	—
Increase or decrease (–) in:							
Checks outstanding, etc.[1]	–0.1	1.1	3.4	—	—	—	—
Deposit fund balances	–0.9	–0.9	–0.8	–1.2	—	—	—
Seigniorage on coins	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Credit financing account balances:							
Increase or decrease (–) in guaranteed loan financing accounts	—	—	3.4	3.7	2.3	0.3	–0.4
Increase (–) or decrease in direct financing accounts	—	—	–3.4	–4.0	–2.9	–3.3	–3.3
Total, means of financing other than borrowing from the public	0.3	10.9	3.1	–1.0	–0.1	–2.5	–3.2
Total, requirements for borrowing from the public	–220.1	–271.3	–345.2	–246.7	–132.2	–76.1	–58.7
Reclassification of debt[2]	—	—	—	–2.1	—	—	—
Change in debt held by the public[3]	220.1	271.3	345.2	248.8	132.2	76.1	58.7
Debt Outstanding, End of Year:							
Gross Federal debt:							
Debt issued by Treasury[3]	3,173.5	3,557.6	4,024.1	4,408.1	4,702.9	4,962.7	5,215.1
Debt issued by other agencies	32.8	19.9	23.8	28.5	25.1	22.6	22.4
Total, gross Federal debt[3]	3,206.3	3,577.5	4,047.9	4,436.6	4,728.0	4,985.3	5,237.5
Held by:							
Government accounts	795.9	895.8	1,020.9	1,160.9	1,320.2	1,501.3	1,694.8
The public[3]	2,410.4	2,681.7	3,026.9	3,275.7	3,407.9	3,484.0	3,542.7
Debt Subject to Statutory Limitation, End of Year:							
Debt issued by Treasury[3]	3,173.5	3,557.6	4,024.1	4,408.1	4,702.9	4,962.7	5,215.1
Deduct (–): Treasury debt not subject to limitation[4]	–15.6	–15.6	–15.6	–15.6	–15.6	–15.6	–15.6
Agency debt subject to limitation	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Unamortized discount or premium (–) on Treasury notes and bonds other than zero-coupon bonds	3.0	3.3	3.3	3.3	3.3	3.3	3.3
Total, debt subject to statutory limitation[5]	3,161.2	3,545.8	4,012.1	4,396.1	4,691.0	4,950.7	5,203.1

*$50 million or less.

[1] Besides checks outstanding, includes accrued interest payable on Treasury debt, miscellaneous liability accounts, allocations of special drawing rights, and, as an offset, cash and monetary assets other than the Treasury operating cash balance, miscellaneous asset accounts, and profit on sale of gold.

[2] The Farm Credit System Financial Assistance Corporation is estimated to be reclassified from a Government-sponsored enterprise to a Federal agency as of October 1, 1992, and its debt is accordingly reclassified as Federal agency debt.

[3] Treasury securities held by the public are measured at accrual value (i.e., sales price plus amortized discount or less amortized premium).

4 Consists primarily of Federal Financing Bank debt.

[5] The statutory debt limit is $4,145 billion.

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202-566-5252

TREASURY AMENDS LIST OF LIBYAN AGENTS

The Treasury Department today added 12 companies and 21 individuals to its list of agents of the Government of Libya. The action is part of ongoing Treasury efforts to enforce the U.S. economic embargo against Libya.

In announcing today's action, R. Richard Newcomb, Director of Treasury's Office of Foreign Assets Control (OFAC), said, "The recent Libyan economic expansion into Western Europe increases Muammar Qadhafi's ability to promote and finance terrorist activity. The U.S. attitude cannot be 'business as usual'."

The 12 companies include three European affiliates of the Houston-based U.S. oil firm, the Coastal Corporation. Control of these three members of Coastal's Holborn Group has been transferred to Libya. Also listed are the three principal offices of Libya's state-owned Foreign Petroleum Investment Corporation, commonly known as "Oilinvest". The remaining six firms are located in Malta.

The 21 individuals include key officers and managers of Oilinvest and the Libyan-controlled entities of the Holborn Group.

As a result of today's action, those listed are now considered "Specially Designated Nationals" (SDNs) of the Government of Libya, bringing them under the embargo and asset freeze imposed against Libya by President Reagan in January 1986. All assets of Libyan SDNs within U.S. jurisdiction, including overseas branches of U.S. banks, are blocked. All economic transactions by U.S. persons with SDNs of Libya are prohibited.

Doing business with a Libyan SDN is equivalent to doing business with the Government of Libya, which carries maximum criminal penalties of $500,000 per violation for corporations and $250,000 per violation for individuals, plus prison sentences of up to 12 years for individuals and senior corporate officers. OFAC also may levy administrative civil penalties of up to $10,000 per violation.

more

NB-1406

The list of Specially Designated Nationals of Libya may be expanded or amended at any time, as new information becomes available to the Treasury Department. Persons with information on individuals or firms owned or controlled by the Government of Libya or acting on behalf of the Government of Libya may call 202-566-5021. All calls will be kept confidential.

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ORGANIZATIONS AND INDIVIDUALS DETERMINED TO BE WITHIN THE TERM "GOVERNMENT OF LIBYA" (SPECIALLY DESIGNATED NATIONALS OF LIBYA)

Companies

CORINTHIA GROUP OF COMPANIES
Head Office, 22, Europa Centre, Floriana, Malta

CORINTHIA PALACE HOTEL COMPANY LIMITED
De Paula Avenue, Attard, Malta

HOLBORN EUROPA RAFFINERIE GmbH
(a.k.a. HER)
Rothenbaumchaussee 5, 4th Floor, D-2000 Hamburg 13
Germany

HOLBORN EUROPEAN MARKETING COMPANY LIMITED
(a.k.a. HEMCL)
Miranda Court No. 1, Ipirou Street, P.O. Box 897
Larnaca, Cyprus

Hofplein 33, 3011 AJ Rotterdam, The Netherlands

HOLBORN INVESTMENT COMPANY LIMITED
(a.k.a. HICL)
Miranda Court No. 1, Ipirou Street, P.O. Box 897
Larnaca, Cyprus

JERMA PALACE HOTEL
Maarsancala, Malta

LAFI TRADE MALTA
14517 Tower Road, Siema, Malta

OILINVEST
(a.k.a. FOREIGN PETROLEUM INVESTMENT CORPORATION)
(a.k.a. LIBYAN OIL INVESTMENTS INTERNATIONAL COMPANY)
(a.k.a. OIIC)
(a.k.a. OILINVEST INTERNATIONAL N.V.)
Netherlands Antilles

Tripoli, Libya

OILINVEST (NETHERLANDS) B.V.
(a.k.a. OILINVEST HOLLAND B.V.)
Museumpln 11, 1071 DJ Amsterdam, The Netherlands

OS OILINVEST SERVICES A.G.
Loewenstrasse 60, Zurich, Switzerland

QUALITY SHOES COMPANY
UB 33, Industrial Estate, San Gwann, Malta

SWAN LAUNDRY & DRY CLEANING COMPANY, LTD.
55, Racecourse Street, Marsa, Malta

Individuals

ABBOTT, John G.
34 Grosvenor Street, London W1X 9FG, United Kingdom

ABDULJAWAD, Muhammed I.
(a.k.a. ABDUL JAWAD, Mohammed)
Tripoli, Libya

AGHIL, Yousef I.
Libya

BUSHWESHA, Abdullah
Libya

CHARALAMBIDES, Kypros
Cyprus

EL BADRI, Abdullah Şalim
Tripoli, Libya

EL GHRABLI, Abdudayem
Libya

EL HUWEIJ, Mohamed A.
Tripoli, Libya

FERJANI, A.S.A.
Tripoli, Libya

GHADAMSI, Bashir
Italy

LAYAS, Mohammed H.
Tripoli, Libya

MANA, Salem
Libya

NAAS, Mahmoud
Libya

PARADISSIOTIS, Christoforos Pavlou
Larnaca, Cyprus

34 Grosvenor Street, London W1X 9FG, United Kingdom

RIECKE, Dr. Hans
Germany

SAUDI, Abdullah A.
Manama, Bahrain

SIALA, Mohamed Taher Hammuda
Tripoli, Libya

STAVROU, Stavros
Cyprus

UGUETO, Luis
Venezuela

WOJTEK, Dr. Ralf
Germany

YOUSEF, Mohamed T.
Libya

TREASURY NEWS

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

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DEPT. OF THE TREASURY

REMARKS BY
THE HONORABLE JOHN E. ROBSON
DEPUTY SECRETARY OF THE TREASURY
TIRANA, ALBANIA
AUGUST 1, 1991

IT IS A GREAT HONOR TO BE HERE IN ALBANIA TO JOIN IN THE BEGINNING OF THE REBIRTH OF YOUR COUNTRY. ON BEHALF OF PRESIDENT BUSH AND THE AMERICAN PEOPLE, I WANT TO THANK THE PEOPLE OF ALBANIA FOR OPENING YOUR ARMS AND YOUR HEARTS TO THE UNITED STATES -- JUST AS YOU HAVE OPENED YOUR COUNTRY TO THE IDEAS OF DEMOCRACY AND FREEDOM.

DURING THE TIME I HAVE SPENT IN YOUR COUNTRY, IT HAS BECOME CLEAR TO ME THAT ALBANIA IS A NATION OF TREMENDOUS HOSPITALITY AND GOOD WILL TOWARD THE AMERICAN PEOPLE, AND WE ARE PROUD TO STAND WITH YOU IN YOUR PURSUIT OF POLITICAL AND ECONOMIC REFORM.

IT IS NO COINCIDENCE THAT I AM VISITING ALBANIA AT THE SAME TIME MY PRESIDENT IS VISITING THE SOVIET UNION. ALTHOUGH THE WORLD MAY SEEM TO HAVE FOCUSED A GREAT DEAL OF ITS ATTENTION ON CHANGES IN THE SOVIET UNION, I AM HERE TO REAFFIRM THE SUPPORT OF THE UNITED STATES FOR THE EMERGING DEMOCRACIES HERE IN ALBANIA AND ELSEWHERE IN EAST AND CENTRAL EUROPE.

IN THE SHORT PERIOD OF TIME SINCE THE FALL OF THE BERLIN WALL AND THE MARCH OF FREEDOM ACROSS EAST AND CENTRAL EUROPE, THE OLDER INDUSTRIAL DEMOCRATIES, SUCH AS THE UNITED STATES, AND NATIONS STRUGGLING TO ACHIEVE DEMOCRACY AND ECONOMIC REFORM, SUCH AS ALBANIA, HAVE LEARNED SOME IMPORTANT LESSONS. BUT THE FIRST LESSON YOU SHOULD LEARN IS THAT YOU ARE NOT FACING YOUR PROBLEMS ALONE. THE ALBANIAN PEOPLE ARE NO LONGER SACRIFICING IN ISOLATION -- OR WITHOUT HOPE.

AS YOUR COUNTRY WORKS TO PUT IN PLACE CHANGES THAT WILL ACHIEVE A TRUE MARKET ECONOMY, THERE ARE STILL SACRIFICES YOU WILL HAVE TO MAKE. SOMETIMES IT MAY SEEM AS THOUGH PROGRESS IS MOVING TOO SLOWLY...THAT VERY LITTLE HAS REALLY CHANGED. BUT, IN FACT, HISTORIC CHANGES ARE BEING MADE. INSTEAD OF SACRIFICING ALONE, WITH NO HOPE OF BETTER THINGS TO COME, YOU NOW HAVE THAT SPECIAL VISION OF HOPE. AND THAT HOPE SHOULD BRING WITH IT AN OPTIMISM FOR A FREER AND BETTER LIFE FOR ALL ALBANIANS. YOU NOW HAVE SOMETHING TO WORK FOR THAT IS YOURS -- AND YOURS ALONE -- FREEDOM AND PROSPERITY.

MANY OTHER FORMER SOCIALIST COUNTRIES, WHICH REJECTED CONTROLLED ECONOMIES FOR FREE AND OPEN MARKETS, HAVE FACED SIMILAR OBSTACLES AND UNCERTAINTIES IN THE BEGINNING THAT THE PEOPLE OF ALBANIA NOW FACE. I REALIZE THAT EACH COUNTRY EMBARKING ON THE DIFFICULT PATHS OF DEMOCRATIC AND ECONOMIC REFORM BELIEVES THAT ITS PROBLEMS ARE UNIQUE. HAVING BEEN CLOSELY INVOLVED WITH THE PROCESS OF REFORM THROUGHOUT EAST AND

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EVERYWHERE, THE RECIPE FOR DEMOCRATIC AND ECONOMIC REFORM [redacted] IS PRETTY MUCH THE SAME:

- O THE GUARANTEE OF FAIR AND OPEN POLITICAL CAMPAIGNS AND ELECTIONS, FREE OF INTIMIDATION, WHERE ALL PARTIES HAVE EQUITABLE ACCESS TO THE MEDIA;

- O THE ASSURANCE OF ADEQUATE CONTROL BY CIVILIAN AUTHORITY OF THE SECURITY SERVICES;

- O LIBERALIZATION OF PRICES AND WAGES;

- O CREATING CLEAR RIGHTS FOR PRIVATE PROPERTY OWNERSHIP, PRIVATIZATION OF STATE ENTERPRISES TO COMPETE IN THE FREE MARKET, AND THE FREEDOM FOR ENTREPRENEURS TO START THEIR OWN BUSINESSES;

- O AND, OPENING YOUR COUNTRY TO FREE TRADE AND INVESTMENT FROM THE REST OF THE WORLD.

THE OTHER EMERGING DEMOCRACIES -- CZECHOSLOVAKIA, BULGARIA, AND OTHERS -- AS WELL AS THOSE COUNTRIES WHO SUPPORT THEIR REFORM -- SUCH AS THE UNITED STATES -- HAVE LEARNED DURING THE REFORM PROCESS. WE HAVE LEARNED WHAT TYPE OF ASSISTANCE IS MOST EFFECTIVE AS NEW DEMOCRACIES STRUGGLE TO REPLACE YEARS OF CONTROL AND EMPTY PROMISES.

WE HAVE LEARNED HOW DIFFICULT IT IS TO MAKE THE TRANSITION FROM AN ECONOMIC SYSTEM WHERE ALMOST EVERYTHING IS OWNED AND DECIDED BY GOVERNMENT, TO A SYSTEM WHERE OWNERSHIP AND ECONOMIC DECISIONS ARE IN THE HANDS OF PRIVATE CITIZENS IN A COMPETITIVE MARKETPLACE.

WE HAVE LEARNED THAT THE TRANSITION TO FREE MARKETS IS NOT FOR THE FAINT-HEARTED -- THAT THE ROPES OF GOVERNMENT COMMAND MUST BE CLEANLY SEVERED. REFORMING COUNTRIES CANNOT SUCCEED BY CONTROLLING FROM THE CENTER. THEY CANNOT GENTLY AND PAINLESSLY PHASE IN THE MARKETPLACE OVER A LENGTHY PERIOD. SUCCESS IS LIKELY TO COME SOONEST TO COUNTRIES THAT CONVERT TO THE FREE MARKET QUICKLY -- WITH NO TURNING BACK. AND THAT IS THE ROAD ALBANIA MUST TAKE AS WELL.

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WE WILL ACTIVELY SUPPORT ALBANIA'S EFFORTS TO BECOME A MEMBER OF THE INTERNATIONAL MONETARY FUND (IMF) AND THE WORLD BANK. THESE ARE IMPORTANT INSTITUTIONS, WITH LARGE RESOURCES, AND AMERICA IS THE LARGEST FINANCIAL BACKER OF ALL OF THEM.

AND WE WILL BRING OUR EXPERTS AND PROVIDE TECHNICAL ASSISTANCE TO HELP YOU FASHION THE POLICIES AND BUILD THE INSTITUTIONS OF THE FREE MARKET, INCLUDING FINANCING AND MONETARY POLICY, PRIVATIZING BUSINESSES, AGRICULTURAL POLICY AND OPERATIONS, HEALTH CARE, MANAGEMENT TRAINING, AND OTHER AREAS.

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- HOPE THAT EVERY ALBANIAN WILL HAVE A VOICE AND A VOTE IN CHOOSING THEIR LEADERSHIP AND INFLUENCING THE POLICIES OF GOVERNMENT;
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- AND, HOPE THAT THEY AND THEIR CHILDREN AND GRANDCHILDREN WILL ENJOY THE PRIDE AND PROSPERITY OF ALBANIA'S MEMBERSHIP IN THE WORLD COMMUNITY OF NATIONS THAT ARE POLITICALLY AND ECONOMICALLY FREE.

THE ACCOMPLISHMENT OF THESE GREAT REFORMS IN DEMOCRACY AND FREE-MARKET ECONOMICS REQUIRE THE STRONG SUPPORT OF THE ALBANIAN PEOPLE. BE PATIENT. DO NOT LET UNREALISTIC EXPECTATIONS ABOUT HOW QUICKLY YOU CAN CREATE A PROSPEROUS FREE MARKET DEFEAT YOUR HISTORIC EFFORTS. I URGE EACH OF YOU TO PARTICIPATE IN THE PROCESS OF REFORM WITH YOUR HANDS, YOUR HEARTS, AND YOUR MINDS.

THE REWARDS WILL BE SUBSTANTIAL. AND I AM OPTIMISTIC THAT THE PEOPLE OF YOUR NATION CAN AND WILL ACCOMPLISH THE TRANSITION WITH THE ENERGY AND SKILL THAT IS SO ABUNDANT AMONG ALBANIANS.

TREASURY NEWS

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

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DEPT. OF THE TREASURY

REMARKS BY
THE HONORABLE JOHN E. ROBSON
DEPUTY SECRETARY OF THE TREASURY
TIRANA, ALBANIA
AUGUST 1, 1991

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GOOD LUCK TO EACH OF YOU. THE UNITED STATES WILL WATCH YOUR REFORMS AND WORK WITH YOU TO MAKE THEM A SUCCESS. THE REST OF THE FREE WORLD RECOGNIZES THE DIFFICULTIES YOU FACE, AND THE EXPECTATIONS YOU HAVE FOR THE FUTURE. WE ARE HERE TO HELP YOU SHOULDER THE TASKS NECESSARY TO REACH YOUR ULTIMATE GOAL -- FREEDOM AND PROSPERITY.

THANK YOU.

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TREASURY NEWS

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DEPT. OF THE TREASURY

For Immediate Release
August 2, 1991

Contact Cheryl Crispen
(202) 566-2041

Statement by
Nicholas F. Brady
Secretary of the Treasury

We are pleased the Senate Banking Committee today reported out comprehensive banking reform legislation. I applaud the Committee's decision to endorse strong new supervisory reforms, nationwide banking and branching, and new affiliations between banks and securities firms, subject to strong safeguards.

Our strategy remains to work for comprehensive banking reform legislation that will attract voluntary capital into the banking industry. We are disappointed that the bill does not adopt provisions which permit private capital to flow freely into the banking industry ahead of the taxpayer. And we are concerned about the narrow view which has succeeded in restricting the existing authority of banks to engage in profitable, low risk financial activities.

We will continue to work with Congress to allow banks the ability to become stronger and more viable. We look forward to working with Congress on comprehensive banking reform when they return from the August recess.

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NB-1408

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
August 5, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,431 million of 13-week bills to be issued August 8, 1991 and to mature November 7, 1991 were accepted today (CUSIP: 912794XM1).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.47%	5.64%	98.617
High	5.51%	5.68%	98.607
Average	5.51%	5.68%	98.607

Tenders at the high discount rate were allotted 65%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	41,620	41,620
New York	29,701,245	8,733,495
Philadelphia	25,240	25,240
Cleveland	73,525	73,525
Richmond	50,810	50,810
Atlanta	32,235	30,860
Chicago	1,810,545	358,795
St. Louis	54,655	11,955
Minneapolis	9,340	9,320
Kansas City	31,100	31,100
Dallas	22,555	22,555
San Francisco	493,030	120,280
Treasury	920,960	920,960
TOTALS	$33,266,860	$10,430,515
Type		
Competitive	$28,986,785	$6,150,440
Noncompetitive	1,738,460	1,738,460
Subtotal, Public	$30,725,245	$7,888,900
Federal Reserve	2,433,415	2,433,415
Foreign Official Institutions	108,200	108,200
TOTALS	$33,266,860	$10,430,515

NB-1409

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
August 5, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,425 million of 26-week bills to be issued August 8, 1991 and to mature February 6, 1992 were accepted today (CUSIP: 912794XY5).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.57%	5.83%	97.184
High	5.59%	5.85%	97.174
Average	5.59%	5.85%	97.174

Tenders at the high discount rate were allotted 87%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	40,030	40,030
New York	24,805,590	8,660,465
Philadelphia	19,680	19,680
Cleveland	49,810	49,810
Richmond	49,865	49,865
Atlanta	31,760	30,760
Chicago	1,682,315	317,015
St. Louis	44,125	21,865
Minneapolis	9,170	9,170
Kansas City	42,750	40,750
Dallas	16,620	16,620
San Francisco	714,940	372,690
Treasury	796,000	796,000
TOTALS	$28,302,655	$10,424,720
Type		
Competitive	$23,056,020	$5,178,085
Noncompetitive	1,476,835	1,476,835
Subtotal, Public	$24,532,855	$6,654,920
Federal Reserve	2,600,000	2,600,000
Foreign Official Institutions	1,169,800	1,169,800
TOTALS	$28,302,655	$10,424,720

NB-1410

TREASURY NEWS

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 6, 1991

Contact: Cheryl Crispen
(202) 566-2041

Robert Glenn Hubbard Appointed Deputy Assistant Secretary for Tax Analysis

Secretary of the Treasury Nicholas F. Brady today announced the appointment of Robert Glenn Hubbard as Deputy Assistant Secretary of the Treasury for Tax Analysis.

Mr. Hubbard, 32, will serve as the economic deputy to Assistant Secretary Kenneth W. Gideon, who has principal responsibility for formulation and execution of United States domestic and international tax policy.

Mr. Hubbard earned both a B.A. and a B.S. degree in 1979 from the University of Central Florida, and an A.M. in 1981, and a Ph.D. in economics from Harvard University in 1983. Since 1988, he has been a professor of economics and finance at Columbia University. Prior to that, he served in residence at the National Bureau of Economic Research. From 1983 to 1988, he served as an Assistant Professor of Economics at Northwestern University.

Mr. Hubbard has also worked on projects with the Federal Reserve, the Brookings Institution, and the J.F.K. School of Government; he has organized several research programs for the National Bureau of Economic Research; and he has published a number of papers for academic and public policy audiences.

Mr. Hubbard is married to Constance Pond Hubbard. They have one child, Robert Andrew Pond Hubbard. They reside in Washington, D.C.

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NB-1411

TREASURY NEWS

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

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AUG 8 9 LO 0 0 0785

DEPT. OF THE TREASURY

FOR RELEASE AT 2:30 P.M.
August 6, 1991

CONTACT: Office of Financing
202/376-4350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $20,800 million, to be issued August 15, 1991. This offering will provide about $1,275 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $19,537 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Monday, August 12, 1991 prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Daylight Saving time, for competitive tenders. The two series offered are as follows:

91-day bills (to maturity date) for approximately $10,400 million, representing an additional amount of bills dated May 16, 1991 and to mature November 14, 1991 (CUSIP No. 912794 XN 9), currently outstanding in the amount of $9,252 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $ 10,400 million, representing an additional amount of bills dated February 14, 1991 and to mature February 13, 1992 (CUSIP No. 912794 XZ 2), currently outstanding in the amount of $ 12,550 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 15, 1991. 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 $ 784 million as agents for foreign and international monetary authorities, and $ 5,340 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

NB-1412

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 one-half hour prior to the closing time for receipt of tenders 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 competitive 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.

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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

8/89

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 6, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 3-YEAR NOTES

Tenders for $14,089 million of 3-year notes, Series T-1994, to be issued August 15, 1991 and to mature August 15, 1994 were accepted today (CUSIP: 912827B84).

The interest rate on the notes will be 6 7/8%. The range of accepted bids and corresponding prices are as follows:

	Yield	Price
Low	6.90%	99.933
High	6.93%	99.853
Average	6.92%	99.880

Tenders at the high yield were allotted 17%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	43,870	43,870
New York	40,489,160	13,053,225
Philadelphia	32,910	32,910
Cleveland	48,665	48,665
Richmond	161,655	66,620
Atlanta	45,495	41,345
Chicago	1,082,595	310,845
St. Louis	54,055	50,055
Minneapolis	27,030	27,005
Kansas City	68,195	68,195
Dallas	24,350	24,350
San Francisco	533,390	141,810
Treasury	179,965	179,965
TOTALS	$42,791,335	$14,088,860

The $14,089 million of accepted tenders includes $1,053 million of noncompetitive tenders and $13,036 million of competitive tenders from the public.

In addition, $988 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $1,993 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

NB-1413

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR RELEASE AT 3:OO PM
August 6, 1991

Contact: Peter Hollenbach
(202) 376-4302

PUBLIC DEBT ANNOUNCES ACTIVITY FOR SECURITIES IN THE STRIPS PROGRAM FOR JULY 1991

Treasury's Bureau of the Public Debt announced activity figures for the month of July 1991, of securities within the Separate Trading of Registered Interest and Principal of Securities program, (STRIPS).

	Dollar Amounts in Thousands
Principal Outstanding (Eligible Securities)	$520,322,776
Held in Unstripped Form	$390,317,061
Held in Stripped Form	$130,005,715
Reconstituted in July	$2,394,560

The accompanying table gives a breakdown of STRIPS activity by individual loan description. The balances in this table are subject to audit and subsequent revision. These monthly figures are included in Table VI of the Monthly Statement of the Public Debt, entitled "Holdings of Treasury Securities in Stripped Form." These can also be obtained through a recorded message on (202) 447-9873.

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PA-65

TABLE VI—HOLDINGS OF TREASURY SECURITIES IN STRIPPED FORM, JULY 31, 1991
(In thousands)

Loan Description	Maturity Date	Principal Amount Outstanding			Reconstituted This Month[1]
		Total	Portion Held in Unstripped Form	Portion Held in Stripped Form	
11-5/8% Note C-1994	11/15/94	$6,658,554	$5,610,554	$1,048,000	$24,000
11-1/4% Note A-1995	2/15/95	6,933,861	6,509,061	424,800	-0-
11-1/4% Note B-1995	5/15/95	7,127,086	5,929,966	1,197,120	4,000
10-1/2% Note C-1995	8/15/95	7,955,901	7,409,501	546,400	27,200
9-1/2% Note D-1995	11/15/95	7,318,550	6,146,950	1,171,600	46,400
8-7/8% Note A-1996	2/15/96	8,575,199	8,373,599	201,600	22,400
7-3/8% Note C-1996	5/15/96	20,085,643	19,871,243	214,400	-0-
7-1/4% Note D-1996	11/15/96	20,258,810	19,968,410	290,400	800
8-1/2% Note A-1997	5/15/97	9,921,237	9,820,037	101,200	-0-
8-5/8% Note B-1997	8/15/97	9,362,836	9,330,836	32,000	-0-
8-7/8% Note C-1997	11/15/97	9,808,329	9,798,729	9,600	-0-
8-1/8% Note A-1998	2/15/98	9,159,068	9,149,788	9,280	-0-
9% Note B-1998	5/15/98	9,165,387	9,128,387	37,000	4,000
9-1/4% Note C-1998	8/15/98	11,342,646	11,213,846	128,800	-0-
8-7/8% Note D-1998	11/15/98	9,902,875	9,557,275	345,600	-0-
8-7/8% Note A-1999	2/15/99	9,719,623	9,695,623	24,000	-0-
9-1/8% Note B-1999	5/15/99	10,047,103	9,176,703	870,400	-0-
8% Note C-1999	8/15/99	10,163,644	10,081,619	82,025	-0-
7-7/8% Note D-1999	11/15/99	10,773,960	10,765,960	8,000	-0-
8-1/2% Note A-2000	2/15/00	10,673,033	10,673,033	-0-	-0-
8-7/8% Note B-2000	5/15/00	10,496,230	10,373,030	123,200	-0-
8-3/4% Note C-2000	8/15/00	11,080,646	11,080,646	-0-	-0-
8-1/2% Note D-2000	11/15/00	11,519,682	11,519,682	-0-	-0-
7-3/4% Note A-2001	2/15/01	11,312,802	11,308,802	4,000	-0-
8% Note B-2001	5/15/01	12,398,083	12,398,083	-0-	-0-
11-5/8% Bond 2004	11/15/04	8,301,806	3,844,206	4,457,600	91,200
12% Bond 2005	5/15/05	4,260,758	1,719,108	2,541,650	118,400
10-3/4% Bond 2005	8/15/05	9,269,713	8,312,113	957,600	46,400
9-3/8% Bond 2006	2/15/06	4,755,916	4,755,916	-0-	-0-
11-3/4% Bond 2009-14	11/15/14	6,005,584	1,452,784	4,552,800	155,200
11-1/4% Bond 2015	2/15/15	12,667,799	2,171,639	10,496,160	50,560
10-5/8% Bond 2015	8/15/15	7,149,916	1,651,996	5,497,920	99,840
9-7/8% Bond 2015	11/15/15	6,899,859	2,139,859	4,760,000	59,200
9-1/4% Bond 2016	2/15/16	7,266,854	6,511,654	755,200	77,600
7-1/4% Bond 2016	5/15/16	18,823,551	16,913,151	1,910,400	20,000
7-1/2% Bond 2016	11/15/16	18,864,448	14,770,288	4,094,160	279,680
8-3/4% Bond 2017	5/15/17	18,194,169	6,279,929	11,914,240	178,400
8-7/8% Bond 2017	8/15/17	14,016,858	9,629,658	4,387,200	155,200
9-1/8% Bond 2018	5/15/18	8,708,639	2,372,639	6,336,000	-0-
9% Bond 2018	11/15/18	9,032,870	1,457,670	7,575,200	7,600
8-7/8% Bond 2019	2/15/19	19,250,798	4,857,198	14,393,600	121,600
8-1/8% Bond 2019	8/15/19	20,213,832	11,002,952	9,210,880	175,680
8-1/2% Bond 2020	2/15/20	10,228,868	4,059,268	6,169,600	250,000
8-3/4% Bond 2020	5/15/20	10,158,883	2,344,323	7,814,560	187,520
8-3/4% Bond 2020	8/15/20	21,418,606	8,029,646	13,388,960	182,080
7-7/8% Bond 2021	2/15/21	11,113,373	9,274,973	1,838,400	9,600
8-1/8% Bond 2021	5/15/21	11,958,888	11,874,728	84,160	-0-
Total		520,322,776	390,317,061	130,005,715	2,394,560

[1] Effective May 1, 1987, securities held in stripped form were eligible for reconstitution to their unstripped form.

Note: On the 4th workday of each month a recording of Table VI will be available after 3:00 pm. The telephone number is (202) 447-9873. The balances in this table are subject to audit and subsequent adjustments.

TREASURY NEWS

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

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 7, 1991

Contact: Barbara Clay
(202) 566-5252

Olin L. Wethington
Assistant Secretary of the Treasury
for International Affairs

Olin L. Wethington was sworn in by Secretary of the Treasury Nicholas F. Brady as Assistant Secretary of the Treasury for International Affairs. He was confirmed by the Senate to this position on July 26, 1991, and was appointed to the position by President Bush on August 2, 1991. Mr. Wethington's responsibilities will cover a wide range of international economic policy issues including the international debt strategy; economic reform in Latin America, East Europe and the Soviet Union; trade and investment; and U.S. Government policy in the international financial institutions.

Since 1990, Mr. Wethington has been serving as Special Assistant to the President and Executive Secretary to the Economic Policy Council. From 1985 to 1990, he was a partner at the law firm of Steptoe & Johnson in Washington D.C. From 1983 to 1985, he served as the Deputy Under Secretary for International Trade at the U.S. Department of Commerce.

Mr. Wethington has also served as Director of the Planning and Evaluation Staff for the International Trade Administration at the Department of Commerce, and Executive Assistant to the Under Secretary for International Trade at the Department of Commerce. Prior to that, he was an Adjunct Professor at Georgetown University Law Center (1980-1981), and worked at the law firm of Steptoe & Johnson.

Mr. Wethington received his B.A. and M.A. in Oriental Studies from the University of Pennsylvania in 1971. He pursued graduate studies in Political Science at Columbia University from 1971 through 1974, and went on to receive his J.D. from Harvard Law School in 1977.

Mr. Wethington was born on November 17, 1948 in Durham, North Carolina. He is married to Nadine Peiffer Wethington, and has three children, Stephanie, Bryan and Catherine. They reside in McLean, Virginia.

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NB-1414

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

LIBRARY ROOM 5310
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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 7, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 10-YEAR NOTES

Tenders for $12,005 million of 10-year notes, Series C-2001, to be issued August 15, 1991 and to mature August 15, 2001 were accepted today (CUSIP: 912827B92).

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

	Yield	Price
Low	7.94%	99.557
High	7.95%	99.489
Average	7.94%	99.557

Tenders at the high yield were allotted 13%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	17,528	17,508
New York	33,703,211	11,704,243
Philadelphia	14,834	14,784
Cleveland	31,794	19,614
Richmond	233,716	29,356
Atlanta	23,507	19,087
Chicago	1,058,042	74,211
St. Louis	22,158	18,158
Minneapolis	9,456	9,455
Kansas City	26,962	26,962
Dallas	9,802	9,747
San Francisco	318,802	38,532
Treasury	23,640	23,630
TOTALS	$35,493,452	$12,005,287

The $12,005 million of accepted tenders includes $582 million of noncompetitive tenders and $11,423 million of competitive tenders from the public.

In addition, $300 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

The minimum par amount required for STRIPS is $1,600,000. Larger amounts must be in multiples of that amount.

NB-1415

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
August 8, 1991

Contact: Peter Hollenbach
(202) 376-4302

PUBLIC DEBT TO EXPAND AVAILABILITY OF AUCTION RESULTS

The Bureau of the Public Debt announced today that it will make the results of marketable securities auctions available on the Commerce Department's Economic Bulletin Board (EBB). Beginning August 12, 1991, with the regular weekly bill auctions, the results of all marketable securities auctions will be available on the EBB on the day of the auction.

The auction day information available on the EBB will include: the type and CUSIP number of the security auctioned, yield and interest rate data, amounts tendered and accepted as well as information about securities issued to Foreign and International Monetary Authorities and the Federal Reserve's System Open Market Accounts.

As a service to those interested in tracking Treasury marketable offerings, Public Debt is making historic information on all auctions of Treasury Bills, Notes and Bonds from 1983 to the present available to EBB subscribers. This archival information will also become available on August 12, 1991.

The EBB is a user friendly service that can be accessed by almost any personal computer with telecommunications capabilities. The EBB is available 24 hours a day. There is a nominal charge to access the bulletin board. In addition to Treasury auction information the EBB presents a wide variety of economic information and statistics. Contact the Commerce Department at (202) 377-1968 for EBB details and subscription information.

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PA-66

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
August 8, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 30-YEAR BONDS

Tenders for $12,008 million of 30-year bonds to be issued August 15, 1991 and to mature August 15, 2021 were accepted today (CUSIP: 912810EK0).

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

	Yield	Price
Low	8.15%	99.721
High	8.19%	99.278
Average	8.17%	99.499

$2,000 was accepted at lower yields.
Tenders at the high yield were allotted 96%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	2,142	2,142
New York	20,067,596	11,637,596
Philadelphia	2,794	2,774
Cleveland	4,520	4,470
Richmond	17,358	17,358
Atlanta	5,691	5,544
Chicago	726,807	260,675
St. Louis	8,595	8,595
Minneapolis	1,721	1,711
Kansas City	5,297	5,297
Dallas	2,927	2,907
San Francisco	256,274	56,239
Treasury	2,231	2,221
TOTALS	$21,103,953	$12,007,529

The $12,008 million of accepted tenders includes $199 million of noncompetitive tenders and $11,809 million of competitive tenders from the public.

In addition, $150 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

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

NB-1416

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 12, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,476 million of 13-week bills to be issued August 15, 1991 and to mature November 14, 1991 were accepted today (CUSIP: 912794XN9).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.29%	5.45%	98.663
High	5.31%	5.47%	98.658
Average	5.30%	5.46%	98.660

Tenders at the high discount rate were allotted 4%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	34,755	34,755
New York	36,767,715	9,077,355
Philadelphia	19,280	19,280
Cleveland	45,385	45,385
Richmond	78,490	77,490
Atlanta	28,875	27,915
Chicago	1,950,220	52,220
St. Louis	55,240	15,240
Minneapolis	8,360	8,360
Kansas City	39,435	39,435
Dallas	24,835	24,835
San Francisco	609,215	77,255
Treasury	976,900	976,900
TOTALS	$40,638,705	$10,476,425
Type		
Competitive	$36,242,980	$6,080,700
Noncompetitive	1,836,820	1,836,820
Subtotal, Public	$38,079,800	$7,917,520
Federal Reserve	2,511,510	2,511,510
Foreign Official Institutions	47,395	47,395
TOTALS	$40,638,705	$10,476,425

An additional $18,305 thousand of bills will be issued to foreign official institutions for new cash.

NB-1417

AUCTION RESULTS
PUBLIC DEBT NEWS
Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 12, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,430 million of 26-week bills to be issued August 15, 1991 and to mature February 13, 1992 were accepted today (CUSIP: 912794XZ2).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.37%	5.61%	97.285
High	5.40%	5.64%	97.270
Average	5.39%	5.63%	97.275

Tenders at the high discount rate were allotted 1%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	33,900	33,900
New York	25,489,400	9,018,400
Philadelphia	18,085	18,085
Cleveland	38,915	38,915
Richmond	50,570	50,570
Atlanta	74,515	74,515
Chicago	1,417,165	242,665
St. Louis	42,755	27,805
Minneapolis	12,940	12,940
Kansas City	47,805	47,805
Dallas	19,110	19,110
San Francisco	593,300	91,300
Treasury	753,805	753,805
TOTALS	$28,592,265	$10,429,815
Type		
Competitive	$23,662,150	$5,499,700
Noncompetitive	1,450,410	1,450,410
Subtotal, Public	$25,112,560	$6,950,110
Federal Reserve	2,850,000	2,850,000
Foreign Official Institutions	629,705	629,705
TOTALS	$28,592,265	$10,429,815

An additional $282,995 thousand of bills will be issued to foreign official institutions for new cash.

NB-1418

TREASURY NEWS

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

FOR RELEASE AT 2:30 P.M.
August 13, 1991

CONTACT: Office of Financing
202/376-4350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $ 20,800 million, to be issued August 22, 1991. This offering will provide about $1,425 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $19,366 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Monday, August 19, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Daylight Saving time, for competitive tenders. The two series offered are as follows:

91-day bills (to maturity date) for approximately $10,400 million, representing an additional amount of bills dated November 23, 1990 and to mature November 21, 1991 (CUSIP No. 912794 WW 0), currently outstanding in the amount of $22,169 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $ 10,400 million, to be dated August 22, 1991 and to mature February 20, 1992 (CUSIP No. 912794 YA 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 22, 1991. 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 $937 million as agents for foreign and international monetary authorities, and $ 5,145 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

NB-1419

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 one-half hour prior to the closing time for receipt of tenders 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 competitive 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.

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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

8/89

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

LIBRARY ROOM 5310
AUG 19 91 00 17 12
DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 16, 1991

Contact: Anne Kelly Williams
(202) 566-2041

Meredith Bennett Oliver Appointed Deputy Assistant Secretary for Policy Management

Secretary of the Treasury Nicholas F. Brady today announced the appointment of Meredith Bennett Oliver as Deputy Assistant Secretary of the Treasury for Policy Management.

Ms. Oliver will serve as an advisor to the Assistant Secretary for Policy Management and will continue to direct the Secretary's scheduling office.

Ms. Oliver joined Treasury in 1985 where she served as the Director of the Office of Business Affairs. From 1987 to 1989 she was Special Assistant to the Assistant Secretary of Public Affairs and Public Liaison. In 1989, Ms. Oliver became the Director of Scheduling.

Prior to joining Treasury, Ms. Oliver was a senior staff assistant to Reagan-Bush 1984 Treasurer Angela Buchanan Jackson. In 1983, she was the assistant to the director of government affairs for the Association of Builders and Contractors. From 1976 until 1982, Ms. Oliver was legislative director for Congressman David Emery. Prior to that she was a legislative aide to Congressman Dave Evans.

Ms. Oliver graduated from Duke University in 1974 with a bachelor of arts degree and received her masters in public administration from George Washington University in 1985. She resides in Washington, D.C. with her husband, Joseph.

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NB-1420

TREASURY NEWS

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

LIBRARY ROOM 5310
AUG 20 1991
DEPT. OF THE TREASURY

FOR RELEASE AT 2:30 P.M.
August 16, 1991

CONTACT: Office of Financing
202/376-4350

TREASURY'S 52-WEEK BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for approximately $12,500 million of 364-day Treasury bills to be dated August 29, 1991 and to mature August 27, 1992 (CUSIP No. 912794 YX 6). This issue will provide about $1,875 million of new cash for the Treasury, as the maturing 52-week bill is outstanding in the amount of $10,631 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Thursday, August 22, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Daylight Saving time, for competitive tenders.

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 29, 1991. In addition to the maturing 52-week bills, there are $19,258 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 $1,871 million as agents for foreign and international monetary authorities, and $7,985 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 $380 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 5176-3.

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 one-half hour prior to the closing time for receipt of tenders 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 competitive 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.

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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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

8/89

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

BU AR ROOM 5310
AUG 19 91 002025
DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE August 19, 1991

Monthly Release of U.S. Reserve Assets

The Treasury Department today released U.S. reserve assets data for the month of July 1991.

As indicated in this table, U.S. reserve assets amounted to $74,816 million at the end of July 1991, down from $74,940 million in June 1991.

U.S. Reserve Assets
(in millions of dollars)

End of Month	Total Reserve Assets	Gold Stock 1/	Special Drawing Rights 2/3/	Foreign Currencies 4/	Reserve Position in IMF 2/
1991					
June	74,940	11,062	10,309	44,940	8,629
July	74,816	11,062	10,360	44,664	8,730

1/ Valued at $42.2222 per fine troy ounce.

2/ Beginning July 1974, the IMF adopted a technique for valuing the SDR based on a weighted average of exchange rates for the currencies of selected member countries. The U.S. SDR holdings and reserve position in the IMF also are valued on this basis beginning July 1974.

3/ Includes allocations of SDRs by the IMF plus transactions in SDRs.

4/ Valued at current market exchange rates.

NB-1422

AUCTION RESULTS
PUBLIC DEBT NEWS
Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

LIBRARY ROOM 5310
DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 19, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,417 million of 13-week bills to be issued August 22, 1991 and to mature November 21, 1991 were accepted today (CUSIP: 912794WW0).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.12%	5.27%	98.706
High	5.18%	5.33%	98.691
Average	5.17%	5.33%	98.693

$3,750,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 83%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	27,295	27,295
New York	25,726,345	8,954,875
Philadelphia	19,440	19,440
Cleveland	48,220	48,220
Richmond	39,040	39,040
Atlanta	28,310	28,310
Chicago	1,644,000	268,500
St. Louis	14,515	14,515
Minneapolis	7,325	7,325
Kansas City	27,995	27,995
Dallas	17,670	17,670
San Francisco	626,655	66,655
Treasury	897,240	897,240
TOTALS	$29,124,050	$10,417,080
Type		
Competitive	$24,974,570	$6,267,600
Noncompetitive	1,585,595	1,585,595
Subtotal, Public	$26,560,165	$7,853,195
Federal Reserve	2,506,085	2,506,085
Foreign Official Institutions	57,800	57,800
TOTALS	$29,124,050	$10,417,080

An additional $2,600 thousand of bills will be issued to foreign official institutions for new cash.

NB-1423

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 19, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,401 million of 26-week bills to be issued August 22, 1991 and to mature February 20, 1992 were accepted today (CUSIP: 912794YA6).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.22%	5.45%	97.361
High	5.24%	5.47%	97.351
Average	5.23%	5.46%	97.356

$3,235,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 16%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	27,895	27,895
New York	29,732,605	9,366,365
Philadelphia	17,680	17,680
Cleveland	30,965	30,965
Richmond	34,495	34,495
Atlanta	30,890	30,890
Chicago	1,304,700	45,650
St. Louis	16,405	16,405
Minneapolis	5,090	5,090
Kansas City	31,205	31,205
Dallas	11,520	11,520
San Francisco	579,650	60,050
Treasury	722,705	722,705
TOTALS	$32,545,805	$10,400,915
Type		
Competitive	$27,879,670	$5,734,780
Noncompetitive	1,248,235	1,248,235
Subtotal, Public	$29,127,905	$6,983,015
Federal Reserve	2,650,000	2,650,000
Foreign Official Institutions	767,900	767,900
TOTALS	$32,545,805	$10,400,915

An additional $2,500 thousand of bills will be issued to foreign official institutions for new cash.

NB-1424

TREASURY NEWS

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

LIBRARY ROOM 5310
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DEPT. OF THE TREASURY

FOR RELEASE AT 2:30 P.M.
August 20, 1991

CONTACT: Office of Financing
202/376-4350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $20,800 million, to be issued August 29, 1991. This offering will provide about $1,550 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $19,258 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Monday, August 26, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Daylight Saving time, for competitive tenders. The two series offered are as follows:

92-day bills (to maturity date) for approximately $10,400 million, representing an additional amount of bills dated May 30, 1991, and to mature November 29, 1991 (CUSIP No. 912794 XP 4), currently outstanding in the amount of $10,051 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $10,400 million, to be dated August 29, 1991, and to mature February 27, 1992 (CUSIP No. 912794 YB 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 29, 1991. In addition to the maturing 13-week and 26-week bills, there are $10,631 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 $1,116 million of the original 13-week and 26-week issues. Federal Reserve Banks currently hold $1,496 million as agents for foreign and international monetary authorities, and $8,010 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-week series).

NB-1425

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 one-half hour prior to the closing time for receipt of tenders 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 competitive 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.

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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

8/89

TREASURY NEWS

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

LIBRARY ROOM 5310

AUG 23 91 002194

DEPT. OF THE TREASURY

FOR RELEASE AT 2:30 P.M.
August 21, 1991

CONTACT: Office of Financing
202/376-4350

TREASURY TO AUCTION 2-YEAR AND 5-YEAR NOTES
TOTALING $21,750 MILLION

The Treasury will auction $12,500 million of 2-year notes and $9,250 million of 5-year notes to refund $10,221 million of securities maturing August 31, 1991, and to raise about $11,525 million new cash. The $10,221 million of maturing securities are those held by the public, including $641 million currently held by Federal Reserve Banks as agents for foreign and international monetary authorities.

The $21,750 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 prices of accepted competitive tenders.

In addition to the public holdings, Federal Reserve Banks, for their own accounts, hold $892 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 offerings and in the official offering circulars.

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Attachment

NB-1426

HIGHLIGHTS OF TREASURY OFFERINGS TO THE PUBLIC
OF 2-YEAR AND 5-YEAR NOTES TO BE ISSUED SEPTEMBER 3, 1991

August 21, 1991

Amount Offered to the Public ...	$12,500 million	$9,250 million
Description of Security:		
Term and type of security	2-year notes	5-year notes
Series and CUSIP designation ...	Series AE-1993 (CUSIP No. 912827 C2 6)	Series S-1996 (CUSIP No. 912827 C3 4)
Maturity date	August 31, 1993	August 31, 1996
Interest rate	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
Premium or discount	To be determined after auction	To be determined after auction
Interest payment dates	The last calendar day of February and August through August 31, 1993	The last calendar day of February and August through August 31, 1996
Minimum denomination available .	$5,000	$1,000
Terms of Sale:		
Method of sale	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%
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
Accrued interest payable by investor	None	None
Payment Terms:		
Payment by non-institutional investors	Full payment to be submitted with tender	Full payment to be submitted with tender
Deposit guarantee by designated institutions	Acceptable	Acceptable
Key Dates:		
Receipt of tenders	Tuesday, August 27, 1991	Wednesday, August 28, 1991
a) noncompetitive	prior to 12:00 noon, EDST	prior to 12:00 noon, EDST
b) competitive	prior to 1:00 p.m., EDST	prior to 1:00 p.m., EDST
Settlement (final payment due from institutions):		
a) funds immediately available to the Treasury ...	Tuesday, September 3, 1991	Tuesday, September 3, 1991
b) readily-collectible check ...	Thursday, August 29, 1991	Thursday, August 29, 1991

TREASURY NEWS

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

LIBRARY ROOM 5310
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923379
DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 22, 1991

Contact: Bob Levine
(202) 566-2041

NEW UNITED STATES INCOME TAX TREATY WITH GERMANY

The Treasury Department today announced that the procedures necessary to bring into force the new income tax treaty with the Federal Republic of Germany were completed in an exchange ceremony held in Washington yesterday. The treaty was signed in Bonn on August 29, 1989, and subsequently ratified by both countries.

The treaty updates a number of provisions of the 1954 U.S.-Germany income tax treaty (as amended in 1965). The treaty:

- o provides national treatment with respect to taxes of all kinds and at all levels of government.
- o eliminates tax on certain preliminary or exploratory activities in the other country;
- o establishes maximum rates of tax on cross-border flows of dividends, interest and royalties;
- o provides certainty by setting out rules for the taxation by the host country of each type of income derived there by the residents of the other country; and
- o provides a mechanism for cooperation between the tax authorities to resolve problems of double taxation and to improve tax compliance.

The treaty generally applies as of Jan. 1, 1990. However, different effective dates apply for several purposes.

First, phase-in rules are provided for certain direct investment dividends, U.S. branch profits, and dividends paid by U.S. regulated investment companies. Second, a taxpayer may elect to have the 1954 treaty apply for 1990 instead of the new treaty. Finally, the new treaty will apply for the territory of the former German Democratic Republic and East Berlin from the date on which the tax law of the Federal Republic of Germany became applicable there (Jan. 1, 1991).

Because of the treaty's effective date, taxpayers may be entitled to claim tax refunds. U.S. resident taxpayers who have already obtained a partial refund, under the 1954 treaty, of tax withheld on dividends paid by a German corporation on or after Jan. 1, 1990 will automatically receive an additional 5 percent refund from the German Finance Office. Others should file a refund claim with: Federal Finance Office, Friedhofstrasse 1, 5300 Bonn 3, Federal Republic of Germany. Detailed instructions for claiming refunds of U.S. tax will be issued shortly.

NB-1427

b) readily-collectible check ... Thursday, August 29, 1991   Thursday, August 29, 1991

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 22, 1991

CONTACT: Office of Financing
202-376-4350

RESULTS OF TREASURY'S AUCTION OF 52-WEEK BILLS

Tenders for $12,584 million of 52-week bills to be issued August 29, 1991 and to mature August 27, 1992 were accepted today (CUSIP: 912794YX6).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.35%	5.67%	94.591
High	5.37%	5.69%	94.570
Average	5.36%	5.68%	94.580

Tenders at the high discount rate were allotted 33%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	22,385	22,375
New York	33,056,535	11,596,835
Philadelphia	12,905	12,405
Cleveland	19,165	19,165
Richmond	29,860	29,860
Atlanta	13,420	13,420
Chicago	2,099,820	382,320
St. Louis	19,770	12,430
Minneapolis	3,970	3,970
Kansas City	19,815	19,815
Dallas	8,000	8,000
San Francisco	607,410	161,810
Treasury	301,310	301,310
TOTALS	$36,214,365	$12,583,715
Type		
Competitive	$32,324,060	$8,693,410
Noncompetitive	620,305	620,305
Subtotal, Public	$32,944,365	$9,313,715
Federal Reserve	3,050,000	3,050,000
Foreign Official Institutions	220,000	220,000
TOTALS	$36,214,365	$12,583,715

NB-1428

AUG-22-1991 15:05 FROM K-PORT PRESS OFC TO WH FOREIGN PRES P.01

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THE WHITE HOUSE

Office of the Press Secretary
(Kennebunkport, Maine)

DEPT. OF THE TREASURY

For Immediate Release **August 22, 1991**

STATEMENT BY THE PRESS SECRETARY

We have entered into agreements with Bolivia to reduce substantially Bolivia's debt to the United States. Reduction of Bolivia's food assistance debt is a major step forward in realizing the goals of the Enterprise for the Americas Initiative (EAI) -- a program which the United States proposed on June 27, 1990, to promote increased trade, investment and growth throughout the hemisphere.

Bolivia's far-reaching steps to reform its economy, including measures to open its investment regime, qualify Bolivia for debt reduction under the EAI. Bolivia is receiving a very substantial reduction of its bilateral debt owed to the United States. Under legislation enacted by Congress last year, the United States is reducing Bolivia's P.L. 480 debt by 80 percent, from approximately $38 million to approximately $7.7 million.

Under separate legal authority to assist the relatively least-developed countries, the United States will eliminate Bolivia's $341 million debt owed to the U.S. Agency for International Development, the first time such relief has been provided outside of Sub-saharan Africa.

These understandings will help pave the way for significant additional funds for environmental projects in Bolivia. In particular, the United States welcomes the commitment of Bolivia to provide $20 million in local currency over 10 years to support environmental activities.

The Administration applauds this important step to reduce Bolivia's debt and provide support for the environment and looks forward to continuing to work with Bolivia and other countries in the region to advance the goals of the Enterprise for the Americas Initiative.

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THE WHITE HOUSE

Office of the Press Secretary
(Kennebunkport, Maine)

For Immediate Release August 22, 1991

FACT SHEET

The Reduction of Bolivia's Debt

Today, President Bush endorsed a major agreement between the Government of Bolivia and the United States Government to reduce Bolivia's official bilateral debt owed to the United States Government on P.L. 480 food assistance loans. Deputy Secretary of the Treasury John Robson signed for the United States and Minister of Planning and Coordination Samuel Doria-Medina signed for Bolivia. This agreement is the second bilateral debt reduction under the Enterprise for the Americas Initiative (EAI).

The debt reduction element of the Initiative is intended to reduce debt owed by countries in Latin America and the Caribbean which have undertaken broad macroeconomic and structural reforms, liberalized their investment regimes, and reached agreement on their commercial bank debt, where appropriate. Bolivia's sound macroeconomic policies, stable and receptive foreign investment regime, and substantial progress in reducing its commercial bank debt meet the standards set under the Initiative.

Implementation of the agreement is contingent on approval of an investment sector loan by the Inter-American Development Bank Board of Directors, which is expected on September 11. The agreement signed today provides for the reduction of Bolivia's food assistance debt to the United States by 80%, from approximately $38 million to $7.7 million.

In addition to this reduction in the stock of debt, we expect to enter into an Environmental Framework Agreement with the Government of Bolivia, which would allow all interest payments on the new reduced obligation to be paid in local currency and channeled into an environmental fund established by Bolivia.

The United States and Bolivia also signed an agreement today to eliminate Bolivia's official bilateral debt owed to the United States Government on loans made by the U.S. Agency for International Development (A.I.D.) A.I.D. Assistant Administrator James Michel signed for the United States and Minister Doria-Medina signed for Bolivia.

The agreement signed today provides for the full forgiveness of Bolivia's A.I.D. debt to the United States, which is approximately $341 million. Congress provided authority (in Section 572 of the Foreign Operations, Export Financing and Related Programs Appropriations Act of 1989) to reduce the A.I.D. debt of relatively least developed countries implementing strong economic reforms. Bolivia is the first country outside of Sub-saharan Africa to receive such debt reduction.

In addition, Bolivia has made a voluntary commitment to provide a bond which will produce $20 million in local currency over 10 years to support environmental activities consistent with the EAI.

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THE WHITE HOUSE

Office of the Press Secretary
(Kennebunkport, Maine)

For Immediate Release August 23, 1991

STATEMENT BY THE PRESS SECRETARY

Today, the United States and Jamaica entered into an agreement to reduce substantially Jamaica's food assistance debt to the United States. Under legislation enacted by Congress last year, the United States is reducing Jamaica's P.L. 480 debt by 80 percent, from approximately $271 million to approximately $54.2 million.

Jamaica is implementing a wide range of reforms aimed at building a strong market-oriented economy. These initiatives, including measures to make the economy more attractive to investors, qualify Jamaica for debt reduction under the EAI.

The agreement represents a major step forward in realizing the goals of the President's Enterprise for the Americas Initiative (EAI) -- a program designed to promote increased trade, investment and growth throughout the hemisphere. It also paves the way for an Environmental Framework Agreement between the United States and Jamaica. Under this agreement, Jamaica will be permitted to make interest payments on the new reduced debt in local currency, paid into an environmental fund established in Jamaica.

# # #

THE WHITE HOUSE

Office of the Press Secretary
(Kennebunkport, Maine)

For Immediate Release August 23, 1991

FACT SHEET

The Reduction of Jamaica's Debt

Today, the Governments of Jamaica and the United States entered into a major agreement to reduce Jamaica's official bilateral debt owed to the United States Government on P.L. 480 food assistance loans. Deputy Secretary of the Treasury John Robson signed for the United States; Minister of Foreign Affairs and Foreign Trade David Coore signed for Jamaica. This agreement is the third bilateral debt reduction under the Enterprise for the Americas Initiative (EAI).

The debt reduction element of the Initiative is intended to reduce debt owed by countries in Latin America and the Caribbean which have undertaken broad macroeconomic and structural reforms, liberalized their investment regimes, and reached agreement on their commercial bank debt, where appropriate. Jamaica is implementing a wide range of reforms aimed at building a strong, market-oriented economy. These initiatives, including measures to make its economy more attractive to investors, qualify Jamaica for debt reduction under the EAI.

Implementation of the agreement is contingent on approval of the trade, finance, and investment sector loan by the Inter-American Development Bank Board of Directors, which is expected on September 18. The agreement signed today provides for the reduction of Jamaica's food assistance debt to the United States by 80%, from approximately $271 million to $54.2 million.

In addition to this reduction in the stock of debt, the United States expects to enter into an Environmental Framework Agreement with Jamaica, which would allow all interest payments on the new reduced obligation to be paid in local currency and channeled into an environmental fund established by Jamaica.

# # #

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239
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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 26, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,408 million of 13-week bills to be issued August 29, 1991 and to mature November 29, 1991 were accepted today (CUSIP: 912794XP4).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.38%	5.55%	98.625
High	5.41%	5.58%	98.617
Average	5.40%	5.57%	98.620

$3,845,000 was accepted at lower yields.
Tenders at the high discount rate were allotted 56%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	29,800	29,800
New York	28,164,880	8,685,750
Philadelphia	19,185	19,185
Cleveland	41,535	41,535
Richmond	98,480	85,280
Atlanta	27,475	26,465
Chicago	1,854,025	497,745
St. Louis	56,245	16,245
Minneapolis	8,060	8,060
Kansas City	32,285	32,285
Dallas	21,610	21,610
San Francisco	520,815	65,935
Treasury	878,540	878,540
TOTALS	$31,752,935	$10,408,435
Type		
Competitive	$27,664,510	$6,320,010
Noncompetitive	1,552,425	1,552,425
Subtotal, Public	$29,216,935	$7,872,435
Federal Reserve	2,411,100	2,411,100
Foreign Official Institutions	124,900	124,900
TOTALS	$31,752,935	$10,408,435

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AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

TREASURY PUBLIC DEBT

FOR IMMEDIATE RELEASE
August 26, 1991

UG 28 91 002597

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

DEPT. OF THE TREASURY

Tenders for $10,447 million of 26-week bills to be issued August 29, 1991 and to mature February 27, 1992 were accepted today (CUSIP: 912794YB4).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.46%	5.71%	97.240
High	5.47%	5.72%	97.235
Average	5.47%	5.72%	97.235

Tenders at the high discount rate were allotted 52%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	31,450	31,450
New York	28,559,755	9,127,470
Philadelphia	12,560	12,560
Cleveland	29,110	29,110
Richmond	40,950	40,950
Atlanta	27,625	27,625
Chicago	1,532,110	316,510
St. Louis	40,415	20,415
Minneapolis	9,965	9,965
Kansas City	41,325	41,325
Dallas	15,790	15,790
San Francisco	683,700	92,740
Treasury	681,535	681,535
TOTALS	$31,706,290	$10,447,445
Type		
Competitive	$27,005,995	$5,747,150
Noncompetitive	1,239,995	1,239,995
Subtotal, Public	$28,245,990	$6,987,145
Federal Reserve	2,550,000	2,550,000
Foreign Official Institutions	910,300	910,300
TOTALS	$31,706,290	$10,447,445

NB-1430

TREASURY NEWS

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

FOR RELEASE AT 2:30 P.M.
August 27, 1991

CONTACT: Office of Financing
202/219-3350

TREASURY OFFERS $5,000 MILLION
OF 16-DAY CASH MANAGEMENT BILLS

The Department of the Treasury, by this public notice, invites tenders for approximately $5,000 million of 16-day Treasury bills to be issued September 3, 1991, representing an additional amount of bills dated March 21, 1991, maturing September 19, 1991 (CUSIP No. 912794 XG 4).

Competitive tenders will be received at all Federal Reserve Banks and Branches prior to 1:00 p.m., Eastern Daylight Saving time, Thursday, August 29, 1991. 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 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 amount 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 12:30 p.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.

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, 1991.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

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 RELEASE AT 2:30 P.M.
August 27, 1991

CONTACT: Office of Financing
202-219-3350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $ 21,200 million, to be issued September 5, 1991. This offering will provide about $ 2,200 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $ 19,011 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Tuesday, September 3, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Daylight Saving time, for competitive tenders. The two series offered are as follows:

91-day bills (to maturity date) for approximately $ 10,600 million, representing an additional amount of bills dated June 6, 1991 and to mature December 5, 1991 (CUSIP No. 912794 XQ 2), currently outstanding in the amount of $ 10,533 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $10,600 million, to be dated September 5, 1991 and to mature March 5, 1992 (CUSIP No. 912794 YC 2).

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, 1991. 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 $ 1,428 million as agents for foreign and international monetary authorities, and $ 4,557 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-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 one-half hour prior to the closing time for receipt of tenders 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 competitive 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.

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR IMMEDIATE RELEASE
August 27, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 2-YEAR NOTES

Tenders for $12,596 million of 2-year notes, Series AE-1993, to be issued September 3, 1991 and to mature August 31, 1993 were accepted today (CUSIP: 912827C26).

The interest rate on the notes will be 6 3/8%. The range of accepted bids and corresponding prices are as follows:

	Yield	Price
Low	6.45%	99.862
High	6.46%	99.843
Average	6.46%	99.843

$45,000,000 was accepted at lower yields.
Tenders at the high yield were allotted 92%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	47,835	47,835
New York	36,884,890	11,191,365
Philadelphia	43,085	43,085
Cleveland	52,590	52,590
Richmond	681,855	121,935
Atlanta	41,920	36,875
Chicago	1,863,935	611,825
St. Louis	61,555	57,555
Minneapolis	31,225	30,145
Kansas City	78,280	73,280
Dallas	21,715	21,705
San Francisco	479,230	77,230
Treasury	230,780	230,780
TOTALS	$40,518,895	$12,596,205

The $12,596 million of accepted tenders includes $1,063 million of noncompetitive tenders and $11,533 million of competitive tenders from the public.

In addition, $758 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $692 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

NB-1433

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 28, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 5-YEAR NOTES

Tenders for $9,305 million of 5-year notes, Series S-1996, to be issued September 3, 1991 and to mature August 31, 1996 were accepted today (CUSIP: 912827C34).

The interest rate on the notes will be 7 1/4%. The range of accepted bids and corresponding prices are as follows:

	Yield	Price
Low	7.36%	99.547
High	7.38%	99.465
Average	7.37%	99.506

$30,000 was accepted at lower yields.
Tenders at the high yield were allotted 9%.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	36,665	36,645
New York	27,319,396	8,647,197
Philadelphia	24,861	24,858
Cleveland	46,079	46,079
Richmond	169,886	66,715
Atlanta	30,765	26,205
Chicago	1,277,778	229,238
St. Louis	30,347	26,347
Minneapolis	17,742	17,715
Kansas City	44,741	44,731
Dallas	14,931	14,931
San Francisco	386,928	63,197
Treasury	61,356	61,356
TOTALS	$29,461,475	$9,305,214

The $9,305 million of accepted tenders includes $725 million of noncompetitive tenders and $8,580 million of competitive tenders from the public.

In addition, $280 million of tenders was awarded at the average price to Federal Reserve Banks as agents for foreign and international monetary authorities. An additional $200 million of tenders was also accepted at the average price from Federal Reserve Banks for their own account in exchange for maturing securities.

NB-1434

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

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DEPT. OF THE TREASURY

August 29, 1991

FEDERAL FINANCING BANK ACTIVITY

Charles D. Haworth, Secretary, Federal Financing Bank (FFB), announced the following activity for the month of July 1991.

FFB holdings of obligations issued, sold or guaranteed by other Federal agencies totaled $186.8 billion on July 31, 1991, posting an increase of $1.6 billion from the level on June 30, 1991. This net change was the result of increases in holdings of agency debt of $2,669.1 million, while holdings of agency assets decreased by $932.5 million and holdings of agency-guaranteed loans decreased by $113.3 million. FFB made 55 disbursements during July.

FFB holdings on July 31, 1991 were the highest in the Bank's history.

Attached to this release are tables presenting FFB July loan activity and FFB holdings as of July 31, 1991.

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FEDERAL FINANCING BANK

JULY 1991 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
AGENCY DEBT					
FEDERAL DEPOSIT INSURANCE CORPORATION					
Note No. FDIC 0002					
Advance #1	7/1	$ 918,000,000.00	10/1/91	5.848%	
Advance #2	7/1	2,912,954,180.82	10/1/91	5.848%	
Advance #3	7/16	2,600,000,000.00	10/1/91	5.864%	
NATIONAL CREDIT UNION ADMINISTRATION					
Central Liquidity Facility					
+Note #557	7/1	13,000,000.00	8/30/91	5.834%	
+Note #558	7/2	1,500,000.00	9/27/91	5.877%	
Note #559	7/12	3,000,000.00	10/09/91	5.857%	
Note #560	7/22	5,000,000.00	9/20/91	5.876%	
Note #561	7/25	5,000,000.00	10/23/91	5.879%	
+Note #562	7/29	10,000,000.00	8/28/91	5.876%	
+Note #563	7/29	13,000,000.00	9/27/91	5.876%	
RESOLUTION TRUST CORPORATION					
Note No. 0010					
Advance #1	7/1	54,082,372,965.22	10/1/91	5.848%	
Advance #2	7/15	500,000,000.00	10/1/91	5.844%	
Advance #3	7/29	2,800,000,000.00	10/1/91	5.876%	
TENNESSEE VALLEY AUTHORITY					
Short-term Bond #106	7/10	273,000,000.00	7/22/91	5.864%	
Short-term Bond #107	7/16	349,000,000.00	7/31/91	5.844%	
Short-term Bond #108	7/22	223,000,000.00	8/5/91	5.889%	
Short-term Bond #109	7/31	140,000,000.00	8/14/91	5.864%	
Short-term Bond #110	7/31	140,000,000.00	8/16/91	5.864%	
Short-term Bond #111	7/31	150,000,000.00	8/19/91	5.864%	

+rollover

FEDERAL FINANCING BANK

JULY 1991 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
GOVERNMENT - GUARANTEED LOANS					
DEPARTMENT OF DEFENSE					
Foreign Military Sales					
Philippines 11	7/26	$ 31,571.00	9/13/93	7.065%	
GENERAL SERVICES ADMINISTRATION					
Foley Square Courthouse	7/8	1,101,529.00	12/11/95	8.116%	
Foley Square Office Building	7/16	900,206.00	12/11/95	8.017%	
Foley Square Office Building	7/30	1,421,100.00	12/11/95	7.894%	
RURAL ELECTRIFICATION ADMINISTRATION					
*Alleghney Electric #93A	7/1	471,913.00	9/30/93	7.123%	7.061% qtr.
*Alleghney Electric #93A	7/1	3,303,391.25	9/30/93	7.123%	7.061% qtr.
*Alleghney Electric #93A	7/1	2,230,434.75	9/30/93	7.123%	7.061% qtr.
*Alleghney Electric #93A	7/1	2,117,739.25	9/30/93	7.123%	7.061% qtr.
*Alleghney Electric #175A	7/1	9,110,273.76	9/30/93	7.134%	7.071% qtr.
*Alleghney Electric #255A	7/1	3,988,000.00	9/30/93	7.137%	7.074% qtr.
*Alleghney Electric #255A	7/1	1,452,000.00	9/30/93	7.137%	7.074% qtr.
*Associated Electric #328	7/1	1,544,554.47	9/30/93	7.135%	7.072% qtr.
*Colorado-Ute Electric #168A	7/1	15,015,365.21	9/30/93	7.134%	7.071% qtr.
*Colorado-Ute Electric #203A	7/1	939,935.14	9/30/93	7.134%	7.071% qtr.
*Colorado-Ute Electric #203A	7/1	589,837.85	9/30/93	7.134%	7.071% qtr.
*Cooperative Power Assoc. #130A	7/1	13,924,545.40	9/30/93	7.127%	7.065% qtr.
*Cooperative Power Assoc. #130A	7/1	4,380,165.35	9/30/93	7.127%	7.065% qtr.
*Cooperative Power Assoc. #240A	7/1	7,545,218.16	9/30/93	7.126%	7.064% qtr.
*KAMO Electric #148	7/1	548,000.00	12/31/19	8.456%	8.368% qtr.
*KAMO Electric #209A	7/1	2,097,000.00	9/30/93	7.125%	7.063% qtr.
*KAMO Electric #266	7/1	1,472,470.59	9/30/93	7.125%	7.063% qtr.
*KAMO Electric #266	7/1	929,764.81	9/30/93	7.125	7.063% qtr.
*KAMO Electric #266	7/1	2,897,999.97	9/30/93	7.125%	7.063% qtr.
*N.W. Electric #176	7/1	838,000.00	7/1/93	7.024%	6.963% qtr.
*N.W. Electric #176	7/1	220,000.00	7/1/93	7.024%	6.963% qtr.
*Oglethorpe Power #320	7/1	15,569,008.25	12/31/19	8.455%	8.367% qtr.
*Oglethorpe Power #320	7/1	2,155,636.37	12/31/19	8.455%	8.367% qtr.
*Oglethorpe Power #320	7/1	4,977,371.88	12/31/19	8.455%	8.367% qtr.
*Southern Mississippi Elec. #330	7/1	879,428.55	12/31/19	8.455%	8.367% qtr.
*Sho-Me Power #324	7/1	924,369.76	12/31/18	8.446%	8.359% qtr.
*Sho-Me Power #324	7/1	572,727.30	12/31/18	8.446%	8.359% qtr.
*Sho-Me Power #324	7/1	1,909,090.91	12/31/18	8.446%	8.359% qtr.
*United Power Assoc. #159A	7/1	1,291,025.63	12/31/19	8.384%	8.298% qtr.
*United Power Assoc. #159A	7/1	2,583,999.99	12/31/19	8.384%	8.298% qtr.
Cornbelt Power #292	7/11	1,251,000.00	1/2/18	8.483%	8.395% qtr.

*maturity extension

FEDERAL FINANCING BANK

JULY 1991 ACTIVITY

BORROWER	DATE	AMOUNT OF ADVANCE	FINAL MATURITY	INTEREST RATE (semi-annual)	INTEREST RATE (other than semi-annual)
TENNESSEE VALLEY AUTHORITY					
Seven States Energy Corporation					
Note A-91-09	7/28	$ 629,057,338.10	10/31/91	5.884%	

FEDERAL FINANCING BANK
(in millions)

Program	July 31, 1991	June 30, 1991	Net Change 7/1/91-7/31/91	FY '91 Net Change 10/1/90-7/31/91
Agency Debt:				
Export-Import Bank	$ 11,238.0	$ 11,238.0	$ -0-	$ -101.9
Federal Deposit Insurance Corporation	6,431.0	2,900.0	3,531.0	6,431.0
NCUA-Central Liquidity Fund	96.7	79.9	16.8	40.1
Resolution Trust Corporation	57,382.4	58,208.0	-825.7	15,900.7
Tennessee Valley Authority	12,828.0	12,881.0	-53.0	-1,554.0
U.S. Postal Service	6,400.6	6,400.6	-0-	-297.2
sub-total*	94,376.6	91,707.5	2,669.1	20,418.7
Agency Assets:				
Farmers Home Administration	51,334.0	52,254.0	-920.0	-715.0
DHHS-Health Maintenance Org.	61.3	66.9	-5.5	-8.2
DHHS-Medical Facilities	76.1	82.7	-6.7	-6.7
Rural Electrification Admin.-CBO	4,463.9	4,463.9	-0-	56.7
Small Business Administration	6.6	6.8	-0.3	-1.8
sub-total*	55,941.9	56,874.3	-932.5	-675.0
Government-Guaranteed Loans:				
DOD-Foreign Military Sales	4,665.4	4,702.2	-36.8	-5,090.2
DEd.-Student Loan Marketing Assn.	4,850.0	4,850.0	-0-	-30.0
DHUD-Community Dev. Block Grant	217.5	218.6	-1.1	-26.4
DHUD-Public Housing Notes +	1,903.4	1,903.4	-0-	-47.4
General Services Administration +	649.9	646.5	3.4	282.6
DOI-Guam Power Authority	29.1	29.1	-0-	-0.7
DOI-Virgin Islands	24.5	24.7	-0.2	-0.7
NASA-Space Communications Co. +	32.7	32.7	-0-	-1,063.2
DON-Ship Lease Financing	1,624.4	1,624.4	-0-	-47.9
Rural Electrification Administration	18,831.5	18,894.3	-62.8	-210.8
SBA-Small Business Investment Cos.	293.4	296.9	-3.5	-89.1
SBA-State/Local Development Cos.	699.9	706.1	-6.2	-41.7
TVA-Seven States Energy Corp.	2,412.6	2,418.7	-6.1	56.5
DOT-Section 511	21.8	21.8	-0-	-1.5
DOT-WMATA	177.0	177.0	-0-	-0-
sub-total*	36,433.1	36,546.4	-113.3	-6,310.6
grand total*	$ 186,751.6	$ 185,128.3	$ 1,623.3	$ 13,433.1

*figures may not total due to rounding
+does not include capitalized interest

AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

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DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
August 29, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 16-DAY BILLS

Tenders for $5,014 million of 16-day bills to be issued September 3, 1991 and to mature September 19, 1991 were accepted today (CUSIP: 912794XG4).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.37%	5.48%	99.761
High	5.39%	5.50%	99.760
Average	5.38%	5.48%	99.761

Tenders at the high discount rate were allotted 61%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	0	0
New York	28,200,000	5,014,500
Philadelphia	0	0
Cleveland	0	0
Richmond	0	0
Atlanta	0	0
Chicago	1,615,000	0
St. Louis	0	0
Minneapolis	0	0
Kansas City	0	0
Dallas	0	0
San Francisco	625,000	0
Treasury	0	0
TOTALS	$30,440,000	$5,014,500
Type		
Competitive	$30,440,000	$5,014,500
Noncompetitive	0	0
Subtotal, Public	$30,440,000	$5,014,500
Federal Reserve	0	0
Foreign Official Institutions	0	0
TOTALS	$30,440,000	$5,014,500

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AUCTION RESULTS

PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

EP 6910005 1 1

FOR IMMEDIATE RELEASE
September 3, 1991

CONTACT: Office of Financing
202-219-3350

DEPT. OF THE TREASURY

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,633 million of 13-week bills to be issued September 5, 1991 and to mature December 5, 1991 were accepted today (CUSIP: 912794XQ2).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.32%	5.48%	98.655
High	5.35%	5.51%	98.648
Average	5.34%	5.50%	98.650

Tenders at the high discount rate were allotted 50%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	33,280	33,280
New York	24,048,550	8,663,050
Philadelphia	19,345	19,345
Cleveland	41,175	41,175
Richmond	92,625	67,625
Atlanta	24,420	22,920
Chicago	1,716,505	741,505
St. Louis	52,490	17,490
Minneapolis	9,580	9,580
Kansas City	33,650	33,650
Dallas	24,340	24,340
San Francisco	546,415	142,915
Treasury	816,020	816,020
TOTALS	$27,458,395	$10,632,895
Type		
Competitive	$23,736,180	$6,910,680
Noncompetitive	1,472,910	1,472,910
Subtotal, Public	$25,209,090	$8,383,590
Federal Reserve	2,175,530	2,175,530
Foreign Official Institutions	73,775	73,775
TOTALS	$27,458,395	$10,632,895

An additional $12,125 thousand of bills will be issued to foreign official institutions for new cash.

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AUCTION RESULTS
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PUBLIC DEBT NEWS

Department of the Treasury • Bureau of the Public Debt • Washington, DC 20239

DEPT. OF THE TREASURY

FOR IMMEDIATE RELEASE
September 3, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,613 million of 26-week bills to be issued September 5, 1991 and to mature March 5, 1992 were accepted today (CUSIP: 912794YC2).

RANGE OF ACCEPTED COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.37%	5.61%	97.285
High	5.39%	5.63%	97.275
Average	5.39%	5.63%	97.275

Tenders at the high discount rate were allotted 53%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	32,460	32,460
New York	24,199,380	9,072,930
Philadelphia	12,035	12,035
Cleveland	30,955	30,955
Richmond	40,915	40,915
Atlanta	32,130	29,680
Chicago	1,364,795	358,845
St. Louis	35,620	18,270
Minneapolis	11,655	11,655
Kansas City	36,395	36,395
Dallas	19,980	19,980
San Francisco	623,560	221,620
Treasury	727,450	727,450
TOTALS	$27,167,330	$10,613,190
Type		
Competitive	$22,527,645	$5,973,505
Noncompetitive	1,259,560	1,259,560
Subtotal, Public	$23,787,205	$7,233,065
Federal Reserve	2,400,000	2,400,000
Foreign Official Institutions	980,125	980,125
TOTALS	$27,167,330	$10,613,190

An additional $208,075 thousand of 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

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DEPT. OF THE TREASURY

FOR RELEASE AT 2:30 P.M.
September 3, 1991

CONTACT: Office of Financing
202-219-3350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $21,200 million, to be issued September 12, 1991. This offering will provide about $2,350 million of new cash for the Treasury, as the maturing bills are outstanding in the amount of $18,861 million. Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Monday, September 9, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Daylight Saving time, for competitive tenders. The two series offered are as follows:

91-day bills (to maturity date) for approximately $10,600 million, representing an additional amount of bills dated June 13, 1991 and to mature December 12, 1991 (CUSIP No. 912794 XR 0), currently outstanding in the amount of $10,266 million, the additional and original bills to be freely interchangeable.

182-day bills (to maturity date) for approximately $ 10,600 million, representing an additional amount of bills dated March 14, 1991 and to mature March 12, 1992 (CUSIP No. 912794 YD 0), currently outstanding in the amount of $ 11,233 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 12, 1991. 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 $ 1,165 million as agents for foreign and international monetary authorities, and $ 4,447 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-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 one-half hour prior to the closing time for receipt of tenders 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 competitive 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.

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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

8/89

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

For Release Upon Delivery
Expected at 1:00 PM
September 4, 1991

STATEMENT OF THE HONORABLE
JEROME H. POWELL
ASSISTANT SECRETARY OF THE TREASURY
FOR DOMESTIC FINANCE
BEFORE THE
SUBCOMMITTEE ON TELECOMMUNICATIONS
AND FINANCE
COMMITTEE ON ENERGY AND COMMERCE
UNITED STATES HOUSE OF REPRESENTATIVES
SEPTEMBER 4, 1991

I am pleased to have this opportunity to explain the Treasury security auction process, the oversight and regulation of the Government securities market, Salomon Brothers' recently admitted violations of auction rules, and that firm's possible violations of securities laws, antitrust laws, general fraud statutes, SEC regulations, and New York Stock Exchange rules. I also am pleased to be able to address some specific issues you have raised concerning government securities market regulation.

While regulation of the government securities markets can be improved, the responsibilities of the various regulators are reasonably well-defined. With respect to the auctions, Treasury determines the amounts and maturities of the securities to be auctioned and sets the auction rules. The Federal Reserve conducts the auctions as Treasury's agent, and together the Treasury and the Federal Reserve review bids for compliance. Both the Treasury and the Federal Reserve have powerful, but limited, sanctions available to them to punish violators of these rules. The Treasury, for example, has forbidden Salomon Brothers to bid in auctions in behalf of its customers. Securities fraud in the form of deliberate violations of auction rules accompanied by false statements to the Treasury and antitrust violations are more generally the enforcement responsibility of the self-regulatory organizations, the SEC, and the Justice Department. In addition, price manipulation and other types of secondary market fraud are also the enforcement responsibility of the SEC and the Justice Department.

We believe that these agencies' legal authority to prosecute fraud and antitrust violations in Treasury auctions is beyond question. However, at a minimum, Treasury would support modifications to current law to strengthen enforcement of

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Treasury auction rules by providing that violations of these rules would also constitute violations of the securities laws.

All government securities brokers and dealers, including those that are financial institutions, are subject to regulation pursuant to the Government Securities Act of 1986. Under that Act, the Treasury was given the role as the rulemaker for government securities brokers and dealers. In its rulemaking capacity, Treasury issued rules for government securities brokers and dealers that adopted many of the existing SEC regulations that already applied to registered brokers and dealers. The responsibility for enforcing these rules was given to the SEC and the self-regulatory organizations for non-financial institution brokers and dealers and to the appropriate Federal banking agencies for financial institutions.

Salomon Brothers is, therefore, subject to comprehensive regulation. As a registered broker/dealer and member firm of the New York Stock Exchange, it is subject to all SEC and NYSE rules, as well as Treasury rules under the Government Securities Act. Based on the recent admissions by Salomon Brothers, it is possible that the firm violated recordkeeping and customer confirmation requirements, as well as other requirements that the SEC and the NYSE have full authority to enforce. Moreover, any allegations of market manipulation or securities fraud, if true, would be a violation of securities laws that the SEC has the authority to enforce. Like all persons and entities, Salomon Brothers and its employees are subject to the antitrust laws and general fraud statutes. Violations of these provisions could result in criminal prosecution by the Justice Department.

As a general matter, the current regulatory structure has usually worked well. And yet the recent revelations of intentional wrongdoing have raised legitimate concerns about the integrity of the marketplace and about the adequacy of regulation and supervision. The ongoing investigations of misconduct are broad ranging. We believe that it is appropriate to conduct an equally careful review of the adequacy of current regulation, with the goal of maintaining the highest standards of integrity while also preserving the liquidity, efficiency, and depth of the government securities market.

We would expect to complete such a review and to report its results to Congress within 90 days. In the interim period, we believe that all parties involved -- including the regulators, market participants, and the Congress -- should exercise restraint. The market for U.S. government securities is the largest, most liquid, and most important financial market in the world. It is the means by which we finance the national debt. Moreover, it is the bedrock of the world financial system. It is essential that the integrity of this market be beyond question and that there be adequate regulation to ensure that integrity.

But it is also essential that hasty action not impair the liquidity and competitiveness of U.S. financial markets.

In my testimony today, I will first discuss Treasury auctions, including the role of the primary dealers and significant auction rules, then present a chronology from Treasury's perspective of developments concerning the February and May auctions, and conclude with a discussion of regulatory issues.

Treasury Auctions

As the chart accompanying my testimony shows, the Treasury Department has auctioned large amounts of marketable Treasury securities in the past ten years. In 1981, Treasury sold over $600 billion of marketable Treasury securities; by 1990, this figure had increased to over $1.5 trillion. As long as there is a budget deficit, the amount of securities Treasury is required to sell will tend to increase, not only to raise funds to cover the shortfall between receipts and expenditures, but also to refinance maturing debt.

The massive Treasury financing requirements have been accomplished in an extraordinarily smooth and efficient manner. In the face of the government's large demands on financial markets, interest rates, nevertheless, have trended down over the last ten years. Treasury believes that the best way to achieve the goal of minimizing borrowing costs to the U.S. taxpayer is to minimize surprises to the market while having in place procedures to ensure the fairness and integrity of the market for Treasury securities.

The Treasury Department has a regular and predictable schedule for offering marketable securities, which is well known to market participants. The Treasury makes an announcement as far in advance as is practical any time there is a change in the usual pattern, so that the market can digest the information and prepare for the offerings.

The Treasury Department provides a large amount of information to the public that helps investors estimate the amount that the Treasury will borrow and the types of securities that the Treasury will offer. At the end of the first month of each calendar quarter, the Treasury holds a press conference to announce the securities to be offered in the regular mid-quarter financing operation. At the press conference, the Treasury also announces estimates of the Treasury's borrowing needs for the current calendar quarter and the succeeding three months.

Currently, the Treasury sells 13- and 26-week bills every week and 52-week bills every four weeks. Two-year and five-year notes are auctioned every month for settlement at the end of the month. Seven-year notes are issued in the middle of the first month of each calendar quarter. The quarterly financings, which settle on the 15th of February, May, August, and November, typically consist of three- and ten-year notes and a thirty-year bond. These regularly scheduled issues amount to about 157 separate securities auctions each year.[1]

The details concerning an offering of marketable securities are announced about one week prior to the auction, and the auction occurs from a few days to about one week prior to the settlement date, depending upon holidays and other vagaries of the calendar.

In a Treasury auction, competitive bidders submit tenders stating the yield (discount rate for bill auctions) at which the bidder wants to purchase the securities. The bids are ranked from the lowest yield to the highest yield required to sell the amount offered to the public. Competitive bidders whose tenders are accepted pay the price equivalent to the yield that they bid. In an auction of Treasury notes or bonds, the coupon rate is determined after the deadline for receipt of competitive tenders, based on the average yield of accepted competitive bids.

Noncompetitive bids for up to $1 million from the public are awarded in full at the weighted average yield of accepted

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[1] The Treasury also offers cash management bills from time to time to raise funds to cover low points in the Treasury cash balance. The maturity dates for cash management bills usually coincide with the regular Thursday maturities of regular weekly and 52-week bills. Short-term cash management bills maturing in a few days or a few weeks may be issued when the Treasury's cash balance is seasonally low. For example, cash management bills may be issued in early April, before the April 15 tax payment date, and mature later in April, when cash balances are at seasonal highs. Short-term cash management bills may be announced, auctioned, and settled in a period as short as one day, if necessary, to ensure that the government does not run out of cash. To shorten the time for the auction and reduce the cost of issuing short-term cash management bills, they usually are issued only in large minimum purchase amounts -- $1 million or more -- and noncompetitive tenders are not accepted.

Longer-term cash management bills are also issued from time to time. For example, the Treasury's borrowing requirement in the final calendar quarter of the year is typically larger than for the April-June quarter, when seasonally high tax payments are due. Cash management bills maturing after the April 15, 1991 tax date were issued in November 1990 to manage Treasury borrowing in light of this seasonal pattern.

competitive bids. The ability to bid on a noncompetitive basis ensures that smaller investors, who may not be able to obtain current market information, can purchase securities at a current market yield. Noncompetitive bidding eliminates the risk that a prospective investor might bid a yield that is too high and not obtain the securities desired or too low and pay too much for the securities. Noncompetitive bidding also benefits the Treasury, since the larger the amount awarded noncompetitively, the less needs to be awarded to competitive bidders at successively higher yields. It also serves the goal of achieving a broad distribution of Treasury securities.

To participate in the auction, any potential investor may submit tender forms to any Federal Reserve Bank or branch, which act as Treasury's agent in the auction, or to the Treasury's Bureau of the Public Debt. The tenders must be received before 12:00 noon, Eastern time, for noncompetitive bids and 1:00 p.m., Eastern time, for competitive bids. Currently, tenders are received at 37 sites. Typically, between 75 and 85 bidders submit competitive tenders in Treasury's auctions for securities to be held in the commercial book-entry system.[2] Additionally, between 850 and 900 bidders submit noncompetitive tenders in Treasury auctions for securities to be held in the commercial book-entry system. Also, on average there are about 19,000 noncompetitive tenders per auction for securities to be held in the Treasury Direct system.[3]

Depository institutions and primary dealers may submit either competitive or noncompetitive tenders for their own account and for the account of customers. All other entities or individuals may submit either competitive or noncompetitive

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[2] The commercial book-entry system for Treasury securities is operated by the Federal Reserve Banks, acting as Treasury's fiscal agents. The Federal Reserve maintains book-entry accounts for depository institutions and other entities such as government and international agencies and foreign central banks. In their book-entry accounts at the Federal Reserve, the depository institutions maintain their own security holdings and holdings for customers, which include other depository institutions, dealers, brokers, institutional investors, and individuals. In turn, the depository institution's customers maintain accounts for their customers. Broker-dealers are currently not permitted to maintain securities accounts directly with the Federal Reserve.

[3] The Treasury Direct system is designed primarily for those who wish to hold Treasury securities to maturity; no custodial or transaction fees are charged. At the end of 1990, 979,522 investors held 2.2 million security accounts in Treasury Direct with a par value of nearly $59 billion.

tenders <u>only</u> for their own accounts. Depository institutions and primary dealers are required to submit customer lists when submitting bids for the accounts of customers. Customer lists for competitive bids must be submitted either with the tender or by the close of the auction. Customer lists for noncompetitive tenders must be received prior to the issue date.

The Federal Reserve Banks review the tenders for accuracy, completeness, and compliance with Treasury's rules and guidelines. The Federal Reserve Banks consult with the Treasury Department prior to taking any action on questionable tenders which could materially affect the results of the auction. The Treasury reserves the right to reject any tender.

Once it has been determined that the tenders have complied with Treasury's rules, the Federal Reserve Banks compile the auction summaries. The noncompetitive summary shows the total amount of noncompetitive bids received by each Federal Reserve district. The competitive bid summary shows the total amount bid at each yield. The summaries include information on specific bidders only when needed to apply the 35% limitation on the amount awarded or bid at a given yield by a single bidder or when specific bids appear irregular. This information is forwarded to the Treasury's Bureau of the Public Debt.

The Bureau of the Public Debt accepts noncompetitive bids in full and then determines the yields that are to be accepted on competitive bids. The amount awarded at the high yield is prorated based on the amount bid at that yield to obtain the offering amount.

Auction results are released to the public around 2:00 p.m., Eastern time, on the auction day.

Role of the Primary Dealers

In order to conduct monetary policy, the Federal Reserve buys and sells government securities in the secondary market. The Federal Reserve determines with which dealers it will trade, and these designated dealers, currently 39 in number, are called primary dealers. Despite the name, designation as a "primary dealer" refers to a secondary market relationship with the Open Market Desk of the Federal Reserve System, <u>not a relationship with the Treasury</u>. The Treasury does not determine which dealers can be primary dealers, nor does it set any criteria for this designation.

The relationship between the Federal Reserve Bank of New York and the primary dealers is a business relationship, not a formal regulatory one. In order to assure itself of the creditworthiness of the primary dealers, the Federal Reserve Bank of New York requires that primary dealers submit reports to it and that they permit FRBNY staff to inspect their operations and books and records.

In addition to requirements that the primary dealers make markets in all maturity sectors of Treasury securities and that their share of the market meet certain minimums, the Federal Reserve expects that primary dealers demonstrate their continued commitment to the market for government securities by participating in Treasury auctions.

Because of their importance to the government securities market, their consistent participation in Treasury auctions, and the monitoring of their creditworthiness by the FRBNY, primary dealers share with depository institutions two privileges in the auctions. As mentioned, only primary dealers and depository institutions can submit bids for customers as well as for themselves. In addition, tenders from primary dealers are accepted without deposit, as is also the case for depository institutions, States, political subdivisions or instrumentalities thereof, public pension and retirement and other public funds, international organizations in which the United States holds membership, and foreign central banks and foreign states. Others must pay in full at the time the tender is submitted or, in the case of notes and bonds, present a guarantee from a commercial bank or primary dealer of 5 percent of the par amount applied for.[4]

That there is a group of dealers with a commitment to the government securities market is a benefit to the Treasury, which offers securities every week of the year. However, it needs to be emphasized that the auction process is open; and that others besides primary dealers can and do participate, either directly, or if they choose, through primary dealers or depository institutions.

The 35% Rule

For the past 29 years, the Treasury has limited the maximum amount of securities awarded to a single bidder in a Treasury offering. The primary reasons for the limitation are to ensure broad distribution of Treasury securities and to make it less likely that ownership of Treasury securities become concentrated in a few hands as a result of the auction.

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[4] Treasury also permits tenders to be received without deposit if there is a preexisting agreement with a depository institution on file at the Federal Reserve Bank that authorizes the Federal Reserve Bank to debit the reserve account of the depository institution on the issue date for the securities purchased by the bidder.

The limitation has evolved over the years. It was first set at 25 percent of the total offering amount and applied only to 3-month and 6-month Treasury bills. Today, for bills, notes, and bonds, the limitation is 35 percent of the <u>public</u> offering. The application of the 35 percent limit to any bidder includes consideration of positions in the futures, forward, and when-issued markets. The same limitation is also applied to the maximum amount Treasury will recognize as having been tendered at any particular yield.

The genesis of the maximum award limitation was the unusual occurrence of a single bidder tendering what would have been a successful bid for an exceptionally high proportion of the 13-week bills auctioned on August 27, 1962 and issued on August 30, 1962. On that occasion, Secretary of the Treasury Douglas Dillon invoked his right to reject any or all tenders, in whole or in part, because of concern about a possible market disturbance that could have resulted from the disproportionate allotment. On August 28, 1962, the Treasury announced that "no single bidder would be awarded more than one quarter of the total supply of bills offered in either the 3- or 6-month bill maturities." Subsequently, it became generally understood and accepted throughout the market as applying to all Treasury offerings of marketable securities.

The rule remained unmodified until May 14, 1979, when two rule changes were announced. First, the maximum award to any single bidder in Treasury security offerings was limited to 25 percent of the total combined amounts of the competitive and noncompetitive awards <u>to the public</u>. This rule excluded from the 25 percent calculation those Treasury securities allotted to the Federal Reserve in exchange for maturing securities for its own account and for the accounts of foreign official institutions. It also excluded Treasury securities allotted to foreign official institutions through the Federal Reserve for new cash.

This change was necessary because, by 1979, the size of bids from foreign official accounts through the Federal Reserve, had grown markedly. As a consequence, the amount of an offering remaining for the "public" had shrunk significantly, despite the general increase in the size of Treasury offerings.

The second modification announced on May 14, 1979, was the requirement, in effect today, that, beginning on June 18, 1979, all bidders in bill auctions report on the tender form the amount of any net long position in excess of $200 million in the bills being offered. This net long position is taken into account to compute whether awards to any single bidder would exceed the award limit. Such positions include when-issued, futures, and forward positions in the bill and holdings of the outstanding bill with the same maturity date as the new offering. Also, a primary dealer bidding on behalf of a customer was required to submit a separate tender for the customer whenever the customer's net long position in the bill being offered exceeded $200 million. This new rule recognized the growing importance of when-issued trading and trading in Treasury bill futures. A similar rule for notes and bonds became effective on December 30, 1981.

The Treasury announced on September 8, 1981, an increase in the limit on the maximum amount any one bidder may purchase in a bill, note, or bond auction to 35% from 25% of the combined amounts of competitive and noncompetitive securities available to the public. This was done to lessen the restrictive effect of the modification made in 1979.

A further modification to the 35% rule was made on July 12, 1990. While continuing to permit bidders to tender for securities at multiple yields, the Treasury announced that at any one yield the Treasury will not recognize amounts tendered in excess of 35 percent of the public offering. This rule change was made necessary because several dealers began to place very large bids, even greater than the total size of the offering, at what turned out to be the high or stop-out yield. Because the Treasury used the amount bid to prorate the securities awarded at the highest yield among all bidders at that yield, a dealer who guessed right about the stop-out yield and submitted a very large bid could obtain a large proportion of the auction at the most favorable yield. The rule change put a stop to this practice and resulted in a more equitable distribution for bids awarded at the highest accepted yield.

This abuse of the proration methodology occurred in the June 27, 1990, auction of four-year notes by a primary dealer who was directly requested not to repeat the practice. This same dealer, along with another bidder, however, placed bids for extremely large amounts at a July 10 auction of Resolution Funding Corporation bonds. This time the amounts were cut back for purposes of proration at the stop-out yield. Two days later, in order to put an end to this practice, Treasury announced the rule change limiting the amount recognized as bid at any one yield to 35% of the public offering.

Other Treasury Auction Rules

Single Bidder Guidelines. On June 1, 1984, the Treasury issued guidelines concerning the definition of a single bidder for the purpose of the $1 million limitation on noncompetitive bids. These guidelines are also used to determine what constitutes a single bidder for purposes of the 35 percent limitation.

When-Issued Trading Prior to Auction. Pre-auction trading in Treasury notes and bonds was effectively prohibited from 1941 to 1975. Pre-auction activity in Treasury bills has never been prohibited, except in the case of noncompetitive bidders. Until 1975, regular Treasury announcements of note and bond auctions included a clause banning from the auction any participants who engaged in purchasing, selling or making agreements on an issue before the auction time and date.

Between February 1975 and July 1977, however, Treasury announcements no longer carried this clause as it was thought to be unnecessary. This allowed a temporary when-issued market in Treasury notes and bonds prior to auction to develop. With the 2-year note auction of July 1977, however, Treasury once again included the provision against pre-auction trading, citing "undesirable speculative activity." This prohibition was effective only for coupon securities.

Treasury decided to allow auction participants to engage in pre-auction trading in order to "eliminate an unnecessary regulation" beginning with the August 1981 issue of two-year notes. Since then, when-issued trading has come to be considered an important and efficient mechanism for reducing the uncertainties surrounding Treasury auctions.

The only significant rule change subsequent to 1981 was an October 1983 Treasury announcement prohibiting when-issued trading on the part of noncompetitive bidders. This prohibition applies to all Treasury securities and was intended to prevent participants from garnering disproportionate shares of an issue through noncompetitive auction bidding.

Bidder Certifications. Bidders are required to certify on the tender form that their net long position in the security being auctioned is not in excess of $200 million, or, if it is in excess, the amount of the long position. Depository institutions and primary dealers must certify that any bids submitted on behalf of customers have been entered under the same conditions, agreements, and certification set forth in the tender form.

The February 1991 Five-Year Note Auction

I would now like to discuss the unauthorized bid received in a Treasury note auction last February.

The Treasury's Bureau of the Public Debt received a call at approximately 1:30 p.m. February 21, 1991, from the Federal Reserve Bank of New York concerning the application of the 35% limitation at a single yield in connection with the five-year note auction that day. The FRBNY requested that a determination be made regarding two separate bid submissions from what appeared to be a single bidding entity -- S.G. Warburg & Co., Inc. (S.G. Warburg).

Salomon Brothers had submitted a tender for a customer identified on the tender as Warburg Asset Management. S.G. Warburg separately submitted a tender at the same yield for its dealer account. Combined, the two bids exceeded 35% of the public offering amount at a single yield by one bidder.

Prior to calling the Treasury, the Federal Reserve Bank of New York had called Salomon Brothers concerning the Warburg Asset Management bid. Salomon Brothers stated that they had made a mistake and that Warburg Asset Management was actually Mercury Asset Management.

The Treasury decided to accept both tenders. However, in an effort to prevent future auction delays and any potential for confusion, uncertainty, and inequity in the handling of bidders, the Treasury, in consultation with the Federal Reserve Bank of New York, decided to investigate the relationship of Mercury Asset Management and S.G. Warburg to determine whether these bidders constituted separate and distinct entities for bidding purposes.

The Treasury discussed the issue with Tom Murphy of Salomon Brothers and with an officer of S.G. Warburg. It was determined that Mercury Asset Management, a British company, is majority owned by the same holding company that owns the British subsidiary that owns the U.S. firm of S.G. Warburg.

After reviewing the facts of the case, the Treasury decided that S.G. Warburg and Mercury Asset Management would be treated as a single bidder for purposes of applying the 35% limitation rule in future auctions. The decision was based primarily on the fact that the Treasury's guidelines for determining a single bidding entity are based on the principle that bidders that share common investment advice and management control are viewed as a single entity.

The Treasury's Bureau of the Public Debt sent a letter dated April 17, 1991 to Mercury Asset Management which provided details concerning the two bids submitted in the February five-year note auction and Treasury's decision to treat the two entities as a single bidder for purposes of the 35% limitation rule. Copies of this letter were sent to officers of S.G. Warburg, S.G. Warburg, PLC (the British parent company), and the Federal Reserve Bank of New York. In addition, a copy of the letter was sent to Mr. Paul Mozer of Salomon Brothers.

As Salomon Brothers has now admitted, the bid from Mercury Asset Management was unauthorized. The securities in question were in fact purchased by Salomon Brothers. It appears from Salomon Brother's public statements that the letter from Treasury played an important role in Mr. Mozer's decision to inform senior management of the fraudulent bid. Salomon Brothers did not inform the government of this violation until August 9.

The May Two-Year Note Auction

The May two-year note auction also attracted attention at the Treasury.

It soon became apparent after the auction of $12.25 billion of two-year notes on May 22, 1991, that a squeeze had developed in the issue. The yield on the two-year notes was out of line with market rates and the notes were "on special" in the repurchase agreement market. (In other words, market participants desiring to borrow temporarily the two-year notes had to accept a significantly lower interest rate on funds they deposited with their counterparties in effect as collateral than the prevailing repo rate.)

A number of market participants contacted the Treasury Department to point out this situation. Treasury Department officials also had details concerning the bids received and awarded to primary dealers and their customers. It appeared from this information that the squeeze had developed because Salomon Brothers and some of its customers had bid more aggressively than others and had been awarded the bulk of the securities. Treasury Department officials thought the situation serious enough to warrant investigation by the Securities and Exchange Commission. In late May, the Treasury told the Division of Market Regulation and the Division of Enforcement of the SEC about the problems stemming from the May auction and provided the SEC information concerning auction awards. The SEC promptly began investigating the matter. In addition, the Antitrust Division of the Justice Department requested information pertinent to its own investigation of the squeeze.

On June 4, a Treasury Department official discussed Treasury's concerns with Mr. Paul Mozer. On June 10, Mr. John Gutfreund, chairman of Salomon Brothers, met with Treasury officials to explain the firm's point of view with respect to the May two-year notes. He did not mention the fraudulent bid in the February auction.

The Treasury was concerned about the squeeze in the May two-year note for several reasons. First, any such squeeze goes against the goal of achieving a broad distribution of securities. If dealers are not reasonably comfortable that they can obtain and deliver securities that they have sold prior to the auction, they will be less likely to participate in pre-auction distribution of new issues. Second, while squeezes can occur for reasons other than market manipulation, squeezes in Treasury securities that appear to be deliberately engineered would likely cause some market participants to question the fairness and integrity of the government securities market. If doubt concerning the fairness of Treasury auctions persists over the longer term, the number of active participants in the government securities market could be reduced. The resulting decline in participation in Treasury auctions and in the liquidity of the secondary market could raise Treasury borrowing costs. Finally, Treasury was concerned that there may have been possible violation of securities and other laws in the government securities market.

Subsequent Developments

On August 9, Mr. Gutfreund, in a telephone call to Under Secretary Glauber, informed him of the unauthorized Mercury bid and his knowledge of this since April.

Also, on August 9, Treasury officials were provided an advance copy of Salomon Brothers' announcement released later that day, in which the firm admitted committing violations of the 35% rule in the December 1990 auction of four-year Treasury notes, the February 1991 auction of five-year notes, and the May 1991 auction of two-year notes and announced the suspension of two managing directors responsible for Treasury securities trading and two other employees.

On August 14, Treasury staff, along with staff from other concerned government agencies, attended meetings at the Justice Department and at the SEC with the law firm of Wachtell, Lipton, Rosen & Katz, which was representing Salomon Brothers in this matter. The Wachtell, Lipton lawyers detailed the results of their investigation of the irregularities and rule violations in Treasury auctions as well as related matters. Also, on August 14, Salomon Brothers publicly announced further details of rule violations in Treasury auctions and the fact that the senior management had been informed in late April of an unauthorized bid in the February 1991 auction but had not informed the appropriate government officials of this.

After consulting with the Federal Reserve and the SEC, the Treasury Department announced on the morning of Sunday, August 18, that, in light of Salomon Brothers' auction rule violations, it would for an indeterminate time not allow the firm to participate in auctions of Treasury securities. This penalty was modified later in the day after Salomon Brothers' board meeting resulted in the immediate resignation of three senior officials of Salomon Brothers, the firing of the two suspended managing directors, and the placing of effective management control of the firm in the hands of Mr. Warren E. Buffett. Mr. Buffett assured Secretary Brady that appropriate controls were being put in place to assure that there would be no future rule violations in Treasury auctions. Consequently, Secretary Brady decided to allow Salomon Brothers to bid in auctions for its own account but not to allow it to submit bids for its customers.

The Treasury was subsequently provided specific information concerning the procedures and controls Salomon Brothers has put in place to assure that there would be no violation of auction rules. The new procedures and controls appear to be a good faith effort to prevent future rule violations.

The Treasury Department is assisting the SEC and the Justice Department in their continuing investigations of Salomon Brothers' activities in the government securities market. While the Treasury Department has no enforcement authority in the area of securities or antitrust law, the Treasury can help these two agencies with its expertise concerning the market for Treasury securities.

Government Securities Act Issues

Mr. Chairman, you asked in your letter to us to address some specific issues concerning government securities market regulation. First of all, we urge that this Subcommittee act expeditiously in reporting legislation extending Treasury's rulemaking authority, which will expire on October 1. We believe that the basic regulatory structure of the Government Securities Act of 1986 (GSA) is sound. It recognizes that Treasury is in the best position to set rules for all brokers and dealers, including financial institutions, that are consistent, assure fairness and integrity in the government securities market, but that do not result in inordinate cost to the taxpayer by not allowing the government to finance itself efficiently. However, some changes need to be made, particularly in the sales practice area. We support the modifications to the Government Securities Act of S.1247.

Sales Practice Rules. Treasury believes that legislation applying sales practice rules to the government securities market will strengthen investor confidence and integrity in the market and will significantly enhance customer protection. Sales practice rules should not result in excessive burdens or significantly increase costs because diversified broker-dealers now must comply with sales practice rules for their corporate and municipal securities activities, while banks that conduct a business in municipal securities must comply with sales practice rules of the Municipal Securities Rulemaking Board. We believe that sales practice rules should apply to all government securities brokers and dealers -- both bank and non-bank broker-dealers.

The GSA was enacted to correct only those areas of documented abuse and weakness in the government securities market (e.g., unregistered broker-dealers and hold-in-custody repos) that existed at the time, because of the concern that excessive regulation would impair the efficient operation of the market. Consequently, the GSA did not grant Treasury the authority to prescribe sales practice rules pertaining to transactions in government securities. Additionally, the GSA continued the restriction placed on the National Association of Securities Dealers (NASD) that prohibits it from applying its sales practice rules to the government securities transactions conducted by its members.

It is difficult to assess the magnitude and severity of the problem given the lack of specific evidence of widespread sales practice abuses. Indeed, some of the well publicized cases involving customer losses in government securities transactions may not have stemmed solely from abusive sales practices. Nevertheless, the government securities market is the only regulated securities market in the United States that does not have sales practice rules. The same kinds of abuses that made sales practice rules necessary in the corporate, municipal, and penny stock markets may well occur in the government securities market. Treasury believes it is necessary to prevent unscrupulous brokers and dealers, who may have operated in these other markets until the advent of sales practice rules, from moving to the government securities market.

Sales practice rules for the government securities market would also enhance protection of smaller, less sophisticated investors, who are attracted to the market because of their desire for safe investments. Additionally, since the government securities market increasingly encompasses instruments that can pose considerably greater price risk than traditional Treasury or agency securities, sales practice rules have become increasingly important.

Any proposed regulatory structure for government securities sales practice rules must retain a prominent oversight role for Treasury, consistent with the regulatory approach set out in the GSA. Such a role is necessary and appropriate given Treasury's strong interest in minimizing the cost to the taxpayer of financing the public debt by maintaining the liquidity, efficiency, and integrity of the government securities market. Treasury is also in a unique position to evaluate the actual or potential impact of sales practice rules on the liquidity and efficiency of the market. Accordingly, Treasury supports S.1247, which would grant authority to regulatory agencies and the NASD to issue government securities sales practice rules, if the Treasury has not determined that the rules would "adversely affect the liquidity and efficiency of the market for Government securities" or "impose any burden on competition not necessary or appropriate" in furtherance of the purposes of the GSA.

Electronic Dissemination of Pricing and Trading Information. Treasury supports expanded disclosure of and access to government securities price and volume information. The expanded availability of such information would serve the public interest. When a broad spectrum of market participants can obtain current, accurate information on market conditions, the competitiveness, liquidity and efficiency of the government securities market should improve, as should the auction process. Moreover, expanded information access would serve to enhance customer protection, since customers would be in a better position to determine actual or potential transaction prices for securities, especially for inactively traded issues, and to evaluate the fairness of trades being proposed by a broker or dealer. Access to more accurate price and volume information also enhances the ability of regulatory authorities and independent auditors to verify that securities transactions and positions have been properly valued.

In its 1987 report, the GAO recommended that the private sector be given time to develop systems that would provide market participants increased access to government securities pricing information. In its follow-up report issued in September 1990, the GAO recommended that Congress legislatively mandate that government securities price and volume information be made available on a real-time basis to anyone willing to pay the appropriate fees and that Treasury be assigned authority to prescribe regulations as needed to ensure that such transaction information is available.

Recently, private sector initiatives such as GOVPX and EJV have become operational and have made significant steps toward disseminating the type of government securities price and volume information that would serve the public interest. Consequently, we fully support the efforts undertaken by these private sector groups in this area. We also recognize that these initiatives are just beginning, and it is uncertain how successful they will ultimately be. In addition, these private sector systems to date do not encompass the market for government securities that are not direct Treasury issuances.

Even with these concerns, we believe these initiatives are an encouraging indication that adequate private sector solutions can be found without the need for additional federal regulation. They should be allowed additional time to develop before any rulemaking authority is determined necessary. Treasury supports S. 1247, which provides for a joint Treasury/SEC/Federal Reserve Board evaluation of private sector initiatives regarding the dissemination of price and volume information that will permit further development of these efforts, while providing for continued scrutiny.

Conclusions

Salomon Brothers' recent admissions are a major development that are bringing the government securities market close scrutiny.

Treasury auctions. Since the May auction and the squeeze in two-year notes, Treasury has been considering changes in its auction rules. We stated in a letter to Chairman Markey dated July 1: "Treasury is concerned that there have been several recent auctions resulting in a concentration of ownership at original issue... Treasury is considering changes in its auction rules that would make this concentration of ownership less likely."

Treasury is currently considering auction rule changes for both this purpose and for better monitoring of compliance with the 35 percent limitation. Already, the Federal Reserve Bank of New York has begun making spot checks with customers of primary dealers to verify the legitimacy and accuracy of bids submitted for customer accounts. This change alone should be sufficient to effectively eliminate any possibility that fraudulent customer bids could successfully be used to violate the 35 percent rule.

With respect to the information advantage that it is perceived gives primary dealers an edge in Treasury auctions, the information that has recently been made available on interdealer broker screen quotes through GOVPX has made for much broader dissemination of market prices. We expect that in the future even more price and volume information will be made generally available. This will make for a more level playing field for all participants in the government securities market and in Treasury auctions.

Finally, with respect to the Salomon Brothers matter, we currently have no evidence that other firms have engaged in the specific types of auction practices admitted to by Salomon Brothers. We do, however, believe it is salutary that major market participants are reviewing their own procedures for participating in the auctions.

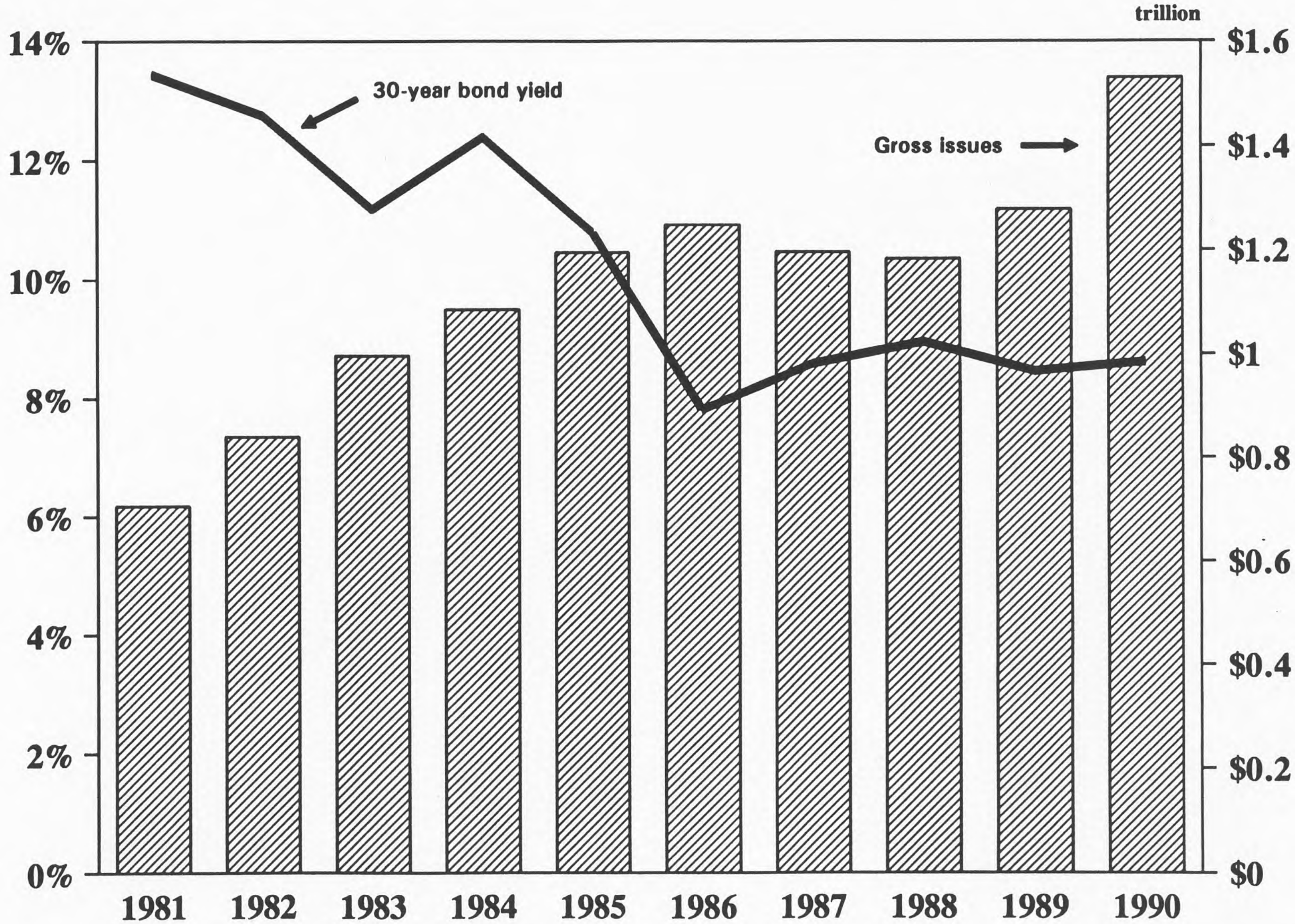
Regulation. Until recently, it had been our view that existing legal authority was sufficient to deal with misconduct in the government securities markets. However, Salomon Brothers' recent admissions of wrongdoing are deeply troubling, as are the allegations of more widespread misconduct in the markets. The entire situation warrants, and is receiving, a sweeping, thorough investigation by the appropriate regulatory authorities.

Until that investigation is reasonably complete, we would prefer to withhold judgment as to the adequacy of existing laws and regulations, as well as existing enforcement capabilities and practices. The market for U.S. government securities is the largest and most important securities market in the world, and any changes in its regulation should only be made after careful collection and review of the facts.

We also recognize the urgency of this matter and the desire of Congress to take prompt and appropriate corrective action. The Treasury, in consultation with the Federal Reserve and the SEC, therefore undertakes to report back to the Congress within 90 days as to any recommended legislative or regulatory changes. We anticipate that this review will address in some depth the adequacy of existing legal authority and enforcement practices to detect and punish wrongdoing in the government securities markets, while also maintaining the extraordinary liquidity and depth of our marketplace.

Questions have also arisen as to the status of the Treasury's rulemaking authority under the Government Securities Act, which will lapse unless reauthorized by October 1. In the view of the Treasury, the Federal Reserve, and the SEC, it is important that there be no such lapse in rulemaking authority. We therefore urge that the reauthorization take place on schedule or that Treasury's rulemaking authority be temporarily extended beyond the October 1 "sunset" date.

Treasury Gross Issues and Bond Yields



Bond yield is annual average Treasury constant maturity 30-year bond yield.
Gross issues are total marketable securities sold.

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

FOR IMMEDIATE RELEASE
SEPTEMBER 5, 1991

CONTACT: BARBARA CLAY
202-566-5252

EXON-FLORIO MADE PERMANENT

Voluntary notices of proposed mergers, acquisitions and takeovers of U.S. businesses by foreign companies or individuals are once again being accepted by the Committee on Foreign Investment in the United States (CFIUS), under the Exon-Florio provision.

CFIUS evaluates the national security impact of takeovers of U.S. businesses by foreign companies or individuals. The evaluation consists of a detailed 30-day review and, if necessary, a 45-day expanded investigation. Following an expanded investigation, the Committee makes a recommendation to the President, who, under the Exon-Florio provision, may stop the takeover if he determines that it threatens national security.

The Exon-Florio provision had lapsed on October 20, 1990, but was made permanent on August 17, 1991, when President Bush signed the Defense Production Act (Public Law 102-99). The new law is effective retroactively, from October 20, 1990.

Takeovers which were reviewed while the law had lapsed, and where CFIUS has already advised the parties that the transaction did not warrant further review, will not be re-examined, assuming that the relevant notification was accurate and complete.

Parties wishing to file notices with CFIUS should continue to follow the proposed regulations published in the Federal Register on July 14, 1989 (54 Fed. Reg. 29744), until final regulations are promulgated.

CFIUS is chaired by the Secretary of the Treasury.

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NB-1441

PUBLIC DEBT NEWS

)epartment of the Treasury • Bureau of the Public Debt • Washington, DC 20239

FOR RELEASE AT 3:OO PM
September 6, 1991

Contact: Peter Hollenbach
(202) 219-3302

PUBLIC DEBT ANNOUNCES ACTIVITY FOR SECURITIES IN THE STRIPS PROGRAM FOR AUGUST 1991

Treasury's Bureau of the Public Debt announced activity figures for the month of August 1991, of securities within the Separate Trading of Registered Interest and Principal of Securities program, (STRIPS).

	Dollar Amounts in Thousands
Principal Outstanding (Eligible Securities)	$544,825,453
Held in Unstripped Form	$413,418,178
Held in Stripped Form	$131,407,275
Reconstituted in August	$4,488,780

The accompanying table gives a breakdown of STRIPS activity by individual loan description. The balances in this table are subject to audit and subsequent revision. These monthly figures are included in Table VI of the Monthly Statement of the Public Debt, entitled "Holdings of Treasury Securities in Stripped Form." These can also be obtained through a recorded message on (202) 447-9873.

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PA-67

TABLE VI—HOLDINGS OF TREASURY SECURITIES IN STRIPPED FORM, AUGUST 31, 1991
(In thousands)

Loan Description	Maturity Date	Principal Amount Outstanding			Reconstituted This Month[1]
		Total	Portion Held in Unstripped Form	Portion Held in Stripped Form	
11-5/8% Note C-1994	11/15/94	$6,658,554	$5,567,354	$1,091,200	$25,600
11-1/4% Note A-1995	2/15/95	6,933,861	6,513,381	420,480	55,680
11-1/4% Note B-1995	5/15/95	7,127,086	5,831,726	1,295,360	48,320
10-1/2% Note C-1995	8/15/95	7,955,901	7,360,301	595,600	-0-
9-1/2% Note D-1995	11/15/95	7,318,550	6,243,750	1,074,800	120,000
8-7/8% Note A-1996	2/15/96	8,575,199	8,379,999	195,200	6,400
7-3/8% Note C-1996	5/15/96	20,085,643	19,871,243	214,400	-0-
7-1/4% Note D-1996	11/15/96	20,258,810	19,968,410	290,400	-0-
8-1/2% Note A-1997	5/15/97	9,921,237	9,820,037	101,200	-0-
8-5/8% Note B-1997	8/15/97	9,362,836	9,330,836	32,000	-0-
8-7/8% Note C-1997	11/15/97	9,808,329	9,800,329	8,000	1,600
8-1/8% Note A-1998	2/15/98	9,159,068	9,149,788	9,280	-0-
9% Note B-1998	5/15/98	9,165,387	9,128,387	37,000	-0-
9-1/4% Note C-1998	8/15/98	11,342,646	11,213,846	128,800	-0-
8-7/8% Note D-1998	11/15/98	9,902,875	9,674,075	228,800	116,800
8-7/8% Note A-1999	2/15/99	9,719,623	9,655,623	64,000	-0-
9-1/8% Note B-1999	5/15/99	10,047,103	9,176,703	870,400	-0-
8% Note C-1999	8/15/99	10,163,644	10,081,619	82,025	-0-
7-7/8% Note D-1999	11/15/99	10,773,960	10,765,960	8,000	-0-
8-1/2% Note A-2000	2/15/00	10,673,033	10,673,033	-0-	-0-
8-7/8% Note B-2000	5/15/00	10,496,230	10,373,030	123,200	-0-
8-3/4% Note C-2000	8/15/00	11,080,646	11,080,646	-0-	-0-
8-1/2% Note D-2000	11/15/00	11,519,682	11,519,682	-0-	-0-
7-3/4% Note A-2001	2/15/01	11,312,802	11,308,802	4,000	-0-
8% Note B-2001	5/15/01	12,398,083	12,398,083	-0-	-0-
7-7/8% Note C-2001	8/15/01	12,339,195	12,339,195	-0-	-0-
11-5/8% Bond 2004	11/15/04	8,301,806	3,897,006	4,404,800	152,000
12% Bond 2005	5/15/05	4,260,758	1,602,308	2,658,450	31,300
10-3/4% Bond 2005	8/15/05	9,269,713	8,365,713	904,000	107,200
9-3/8% Bond 2006	2/15/06	4,755,916	4,755,916	-0-	-0-
11-3/4% Bond 2009-14	11/15/14	6,005,584	1,379,984	4,625,600	64,800
11-1/4% Bond 2015	2/15/15	12,667,799	2,166,679	10,501,120	-0-
10-5/8% Bond 2015	8/15/15	7,149,916	1,688,156	5,461,760	55,040
9-7/8% Bond 2015	11/15/15	6,899,859	2,139,859	4,760,000	-0-
9-1/4% Bond 2016	2/15/16	7,266,854	6,511,654	755,200	-0-
7-1/4% Bond 2016	5/15/16	18,823,551	16,991,551	1,832,000	80,000
7-1/2% Bond 2016	11/15/16	18,864,448	15,504,928	3,359,520	925,840
8-3/4% Bond 2017	5/15/17	18,194,169	6,187,769	12,006,400	343,360
8-7/8% Bond 2017	8/15/17	14,016,858	9,343,258	4,673,600	24,000
9-1/8% Bond 2018	5/15/18	8,708,639	2,335,839	6,372,800	92,800
9% Bond 2018	11/15/18	9,032,870	1,408,270	7,624,600	45,000
8-7/8% Bond 2019	2/15/19	19,250,798	5,185,198	14,065,600	438,400
8-1/8% Bond 2019	8/15/19	20,213,832	10,911,432	9,302,400	136,000
8-1/2% Bond 2020	2/15/20	10,228,868	4,036,868	6,192,000	358,800
8-3/4% Bond 2020	5/15/20	10,158,883	2,665,443	7,493,440	512,320
8-3/4% Bond 2020	8/15/20	21,418,606	7,649,006	13,769,600	624,320
7-7/8% Bond 2021	2/15/21	11,113,373	9,002,973	2,110,400	99,200
8-1/8% Bond 2021	5/15/21	11,958,888	10,299,048	1,659,840	24,000
8-1/8% Bonds 2021	8/15/21	12,163,482	12,163,482	-0-	-0-
Total		544,825,453	413,418,178	131,407,275	4,488,780

[1] Effective May 1, 1987, securities held in stripped form were eligible for reconstitution to their unstripped form.

Note: On the 4th workday of each month a recording of Table VI will be available after 3:00 pm. The telephone number is (202) 447-9873.

AUCTION RESULTS

PUBLIC DEBT NEWS

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FOR IMMEDIATE RELEASE
September 9, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 13-WEEK BILLS

Tenders for $10,662 million of 13-week bills to be issued September 12, 1991 and to mature December 12, 1991 were accepted today (CUSIP: 912794XR0).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.27%	5.43%	98.668
High	5.30%	5.46%	98.660
Average	5.29%	5.45%	98.663

Tenders at the high discount rate were allotted 12%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	25,655	25,655
New York	32,076,055	9,369,455
Philadelphia	17,640	17,640
Cleveland	49,665	49,665
Richmond	46,240	43,600
Atlanta	39,990	38,110
Chicago	1,471,320	81,120
St. Louis	56,975	16,975
Minneapolis	8,900	8,900
Kansas City	36,550	36,550
Dallas	24,840	24,840
San Francisco	532,980	86,045
Treasury	863,155	863,155
TOTALS	$35,249,965	$10,661,710
Type		
Competitive	$31,391,375	$6,803,120
Noncompetitive	1,580,330	1,580,330
Subtotal, Public	$32,971,705	$8,383,450
Federal Reserve	2,210,255	2,210,255
Foreign Official Institutions	68,005	68,005
TOTALS	$35,249,965	$10,661,710

An additional $27,795 thousand of bills will be issued to foreign official institutions for new cash.

NB-1442

AUCTION RESULTS
PUBLIC DEBT NEWS
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September 9, 1991

CONTACT: Office of Financing
202-219-3350

RESULTS OF TREASURY'S AUCTION OF 26-WEEK BILLS

Tenders for $10,660 million of 26-week bills to be issued September 12, 1991 and to mature March 12, 1992 were accepted today (CUSIP: 912794YD0).

RANGE OF ACCEPTED
COMPETITIVE BIDS:

	Discount Rate	Investment Rate	Price
Low	5.30%	5.54%	97.321
High	5.31%	5.55%	97.316
Average	5.30%	5.54%	97.321

Tenders at the high discount rate were allotted 27%.
The investment rate is the equivalent coupon-issue yield.

TENDERS RECEIVED AND ACCEPTED (in thousands)

Location	Received	Accepted
Boston	29,855	29,855
New York	31,395,040	9,558,715
Philadelphia	18,470	18,470
Cleveland	33,675	33,675
Richmond	46,170	41,060
Atlanta	44,675	39,675
Chicago	1,082,495	61,395
St. Louis	38,780	18,780
Minneapolis	10,665	10,665
Kansas City	47,285	47,285
Dallas	20,060	20,060
San Francisco	736,935	82,185
Treasury	697,755	697,755
TOTALS	$34,201,860	$10,659,575
Type		
Competitive	$29,804,315	$6,262,030
Noncompetitive	1,309,950	1,309,950
Subtotal, Public	$31,114,265	$7,571,980
Federal Reserve	2,400,000	2,400,000
Foreign Official Institutions	687,595	687,595
TOTALS	$34,201,860	$10,659,575

An additional $242,005 thousand of bills will be issued to foreign official institutions for new cash.

NB-1443

TREASURY NEWS

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Expected at 2:00 p.m.
September 10, 1991

STATEMENT OF
KENNETH W. GIDEON
ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON TAXATION
COMMITTEE ON FINANCE
UNITED STATES SENATE

Mr. Chairman and Members of the Subcommittee:

I am pleased to present the views of the Administration on the tax simplification proposals currently under your consideration. My testimony today will address S. 1394, the Tax Simplification Act of 1991, and S. 1364, the Employee Benefits Simplification and Expansion Act of 1991. In addition, in accordance with your invitation to testify, I urge your favorable consideration of other proposals not included in these two bills, specifically in the areas of payroll tax deposits, the earned income tax credit, and pension coverage and portability.

As I stated earlier this year before the House Committee on Ways and Means, the Administration strongly supports simplification of our tax laws within the fiscal constraints of last year's budget agreement. Properly conceived and executed simplification can reduce the costs of tax administration and compliance, enhance both voluntary compliance and tax enforcement efforts, and improve taxpayer morale. When simplification efforts are successful, we believe that there should be efficiency gains as well. Simplification is not viable as a revenue-losing proposition, however, and the Administration will insist that the pay-as-you-go provision of the budget agreement be satisfied by any combination of simplification proposals ultimately adopted.

I particularly want to commend Chairman Bentsen and Senator Packwood for their sponsorship and support of the bi-partisan simplification bill, S. 1394. That bill and its House counterpart, H.R. 2777, were produced through the cooperative efforts of the committee staffs which deal with tax matters, the Treasury Department and the Internal Revenue Service. We believe the process used to develop these bills was constructive and has produced good draft legislation. We recognize that a number of modifications to the introduced legislation have been suggested by commentators. While I have not addressed these suggestions in my written testimony today given the need to set forth our basic position for the record and the significant volume of the statement required to accomplish that objective, we will review the record developed here and in the House and will work with the Committees and the staff to adopt meritorious suggestions. We look forward to working with this Committee to perfect these draft proposals and to enact them.

Before turning to S. 1394 and S. 1364, I will describe three additional proposals which we believe will simplify and improve the tax law while meeting the constraint of revenue neutrality.

A. PAYROLL TAX DEPOSITS

The Treasury Department shares with members of this Committee an interest in simplifying the current employment tax deposit system. We have previously indicated that the payroll tax provisions of H.R. 2775 would achieve simplification. Under that proposal, semi-weekly deposits would be required instead of eighth-monthly deposits as under the current system. Next-day deposits would continue to be required for liabilities of $100,000 or more. Employers with under $3,500 of quarterly liability would only be required to make one payment per quarter, and an employer would be able to determine whether it was eligible for this small employer exception at the beginning of each quarter. Also, the underpayment safe harbors for each deposit would be reduced from 5 percent under the current system to the greater of $150 or 2 percent.

Senator Baucus has made a similar payroll tax simplification proposal in S. 1610. This proposal would also require semi-weekly deposits. It would differ from H.R. 2775, however, in that: (1) small employers would be required to make monthly rather than quarterly deposits; (2) the threshold for treatment as a small employer would be $18,000 of quarterly liability; and (3) the minimum amount of permitted safe harbor underpayments would be $250.

S. 1610, like H.R. 2775, would further the goal of simplification. However, in its current form, we preliminarily estimate S. 1610 would result in a significant revenue loss over the 5-year budget period. Our current estimate is that the revenue loss would be about $2.2 billion if small employers were allowed to underpay each monthly deposit by up to $250. The loss would be about $0.6 billion if small employers were not allowed to use this safe harbor to underpay their monthly deposits.

These revenue losses could, however, be offset under S. 1610 if the threshold for small employer treatment (<u>i.e.</u>, monthly deposit) were lowered. We currently estimate that revenue-neutrality could be achieved with a threshold of about $14,000, if safe harbors were not permitted for monthly deposits or, alternatively, with a threshold of about $8,000 if safe harbors were allowed. We question whether a safe harbor as large as $250 is needed by monthly depositors, and a significantly lower level would allow the monthly deposit threshold to be closer to the $14,000 level, thereby maximizing the number of eligible employers.

The Administration believes that S. 1610, if modified to be revenue-neutral, and the payroll tax provisions of H.R. 2775 merit serious consideration.

B. EARNED INCOME TAX CREDIT

The earned income tax credit (EITC) is a refundable tax credit available to low-income workers with children. The EITC consists of (i) a basic credit, which is adjusted for family size, (ii) a health insurance credit, and (iii) a supplemental credit for workers with a child under the age of one (the "young child" or "wee tots" credit). The Omnibus Budget Reconciliation Act of 1990 increased the basic credit rate and added the family size adjustment, the health credit, and the young child credit.

In 1991, the basic EITC rate is 16.7 percent of the first $7,140 of earned income for a worker with one qualifying child and 17.3 percent of that amount for a worker with two or more qualifying children. A worker with one child may receive a basic EITC of up to $1,192. For a worker with two or more children, the maximum basic credit is $1,235.

The young child credit increases the basic EITC rate by 5 percentage points. The maximum young child credit for 1991 is $357. A credit is also available to taxpayers who purchase health insurance that includes coverage for a qualifying child. In 1991, the health insurance credit is equal to 6 percent of the first $7,140 of earned income. However, the credit cannot exceed the actual amount of health insurance expenses. In 1991, the maximum health insurance credit is $428.

For 1991, the basic EITC is reduced by an amount equal to 11.93 percent of the excess of adjusted gross income (or, if greater, earned income) of more than $11,250. The phase-out rate for a family with two or more children is 12.36 percent. Using the same income threshold, the young child credit and health insurance credit increase the phase-out rates respectively by 3.57 percentage points and 4.285 percentage points. The basic EITC and the supplemental credits are not available to taxpayers with adjusted gross incomes (or, if greater, earned income) of approximately $21,250. In 1992 and thereafter, the maximum amount of earnings on which the credit may be taken and the income level at which the phase-out range begins will be adjusted for inflation.

In 1992, the basic EITC rate will increase to 17.6 percent for a worker with one child and 18.4 percent for a worker with two or more children. The corresponding percentages for 1993 are 18.5 percent and 19.5 percent. For 1994 and subsequent years, the credit rates are 23 percent and 25 percent. The phase-out rates for families with one child are 12.57 percent in 1992, 13.21 percent in 1993, and 16.43 percent in 1994 and thereafter. For families with two or more children, these rates are 13.14 percent in 1992, 13.93 percent in 1993, and 17.86 percent in 1994 and thereafter.

Several "interaction rules" prevent a taxpayer from receiving the full benefit of the health insurance credit or the young child credit and other tax provisions.

1. <u>Itemized deduction for medical expenses</u>. The health insurance credit reduces the amount of expenses for which a medical expense deduction is allowed.

2. <u>Deduction for health insurance expenses of the self-employed</u>. Qualifying expenses for the self-employed health insurance deduction are similarly reduced by the amount of the health insurance credit.

3. <u>Child and dependent care tax credit</u>. A taxpayer may not claim both the young child credit and the child and dependent care tax credit with respect to the same child.

4. <u>Exclusion for employer-provided dependent care assistance</u>. Similarly, the same child cannot qualify the taxpayer for both the young child credit and the exclusion for employer-provided dependent care assistance.

We propose that the interaction rules described above be repealed. To offset the revenue losses due to this repeal, the basic EITC percentage rates would be reduced by .05 percent, and the phase-out rates would be reduced by .04 percent. The resulting rates are as follows:

	Credit percentage	Phase-out percentage
For 1992:		
1 qualifying child	17.55	12.53
2 or more qualifying children	18.35	13.10

For 1993:		
1 qualifying child	18.45	13.17
2 or more qualifying children	19.45	13.89
For 1994 and thereafter:		
1 qualifying child	22.95	16.39
2 or more qualifying children	24.95	17.82

The interaction rules create complexity in the EITC and will hinder compliance. Some taxpayers must complete numerous steps in order to calculate their credit amounts and tax liabilities. For example, a taxpayer who is eligible for both the young child credit and the child and dependent care tax credit must calculate both credits to determine which provides the greater benefit. In making this comparison, the taxpayer must also account for the fact that the child and dependent care credit, unlike the young child supplement, is non-refundable and thus potentially less valuable than its face value. Workers receiving child care assistance through their employers will have to make similar comparisons. Because they will have to choose between the young child credit and the exclusion for employer-provided assistance during the tax year, these workers will have to base the computations on estimates of their annual income, child care expenditures and tax liabilities. In other cases, some taxpayers will have to depart from normal practice and complete the credit portion of their tax form (located at the end of the Form 1040) before calculating itemized deductions or the self-employed health insurance deduction.

Self-employed workers with health insurance expenses must perform particularly complicated calculations. The health insurance EITC is subtracted from the amount of expenses allowable for the self-employed health insurance deduction which in turn is used in deriving adjusted gross income (AGI). These computations are circular because the EITC, including the health insurance supplement, is based partly on AGI. The proposed Technical Corrections Act of 1991 (H.R. 1555 and S. 750) includes a provision that would resolve this circularity. Nonetheless, this provision would not eliminate the interaction between the two provisions. A taxpayer will still be required to calculate the self-employed health insurance deduction and AGI twice. As a first step, a taxpayer must calculate AGI as if the taxpayer were entitled to the full health insurance deduction. Using this "hypothetical" measure of AGI, the taxpayer would then compute the EITC, including the health insurance component. Next, the taxpayer must subtract the health insurance EITC from the amount of expenses allowable for the self-employed health insurance deduction in order to calculate "true" AGI. These calculations will require a separate 19-line worksheet to supplement the 2-page EITC schedule.

The interaction rules also limit the Internal Revenue Service's ability to compute the EITC for some taxpayers. In many cases, the Internal Revenue Service (IRS) can automatically determine the EITC if the taxpayer provides basic information on the first page of the EITC schedule. However, the IRS cannot determine the full EITC amounts for self-employed workers who claim both the health insurance credit and the self-employed health insurance deduction because it will not have sufficient information to compute the "hypothetical" AGI amount described above without reference to other data which may not be easy to obtain.

The Office of Tax Analysis estimates that about 500,000 taxpayers are subject to these interaction rules. Repealing these rules will cost about $24 million a year ($25 million a year if the self-employed health insurance deduction is extended beyond 1991). Although relatively few taxpayers are subject to these rules, all EITC recipients may be adversely affected by their complexity. The new EITC schedule will be accompanied by 2 or 3 pages of instructions, and many taxpayers may find it necessary to consult an IRS publication explaining the new credit. Although every effort is being made to keep this guidance as simple as possible, the complexity of the interaction rules may make it difficult for taxpayers to determine whether the rules apply. In the past, complex rules have contributed to high error rates in EITC payments. These high error rates prompted the adoption last year of simplified eligibility rules. Our proposal continues this effort.

To offset the revenue losses due to repeal of the interaction rules, we are proposing a very small reduction in the basic credit rates. Under the proposal, no taxpayer's credit would be reduced by more than $3.71 per taxpayer in 1992 while other credit recipients will benefit by elimination of the interactions.

C. PENSION SIMPLIFICATION, COVERAGE AND PORTABILITY

We are pleased that this Committee is seriously considering simplification of the tax laws relating to pensions. The Administration has concluded that improvements in pension coverage and pension portability can be achieved as part of the tax simplification effort. We believe that we can expand pension coverage, particularly in the small business sector, and enhance pension portability thereby strengthening the role of private pension plans in retirement income planning.

Over the course of the last year, the Administration has focused on these policy issues. Through the joint efforts of the Treasury Department and the Department of Labor, proposals to simplify the tax law governing retirement plans, to expand pension coverage, and to increase pension portability have been developed. These proposals were announced on April 30, 1991, by Secretary of Labor Martin.

The Administration's proposals have been crafted to accomplish these objectives within the constraint of revenue neutrality and, in total, do not lose revenue as the Office of Tax Analysis estimates of the Administration proposals demonstrate (Table I).

The Administration's proposals include the following:

1. <u>Simplify and encourage tax-free rollovers</u>. We propose to simplify and encourage tax-free "rollovers" of pension distributions into IRAs or qualified plans by allowing all plan distributions to be rolled over, except distributions which are made in the form of a life annuity or in installment payments over 10 years or more. The current law restrictions on rollovers of after-tax employee contributions and minimum required distributions would be retained. Plans would be required to offer employees an election to have distributions eligible for rollover treatment transferred directly to an IRA or other qualified plan that accepts such contributions. The favorable income tax treatment for pension distributions which are not rolled over -- the special averaging rules and the deferral of tax on the appreciation on employer securities -- would be repealed and the method for determining the taxable amount of pension annuities would be simplified. The six rules potentially applicable to a pension distribution would be simplified to a single rule providing that such distributions are currently taxed unless they are rolled over. However, our proposals do not contemplate that the thresholds for imposition of the excise tax on excess pension distributions will be changed.

2. <u>Establish a new simplified employee pension program</u>. Employers with 100 or fewer employees and no other retirement plan would be eligible for the new plan. Under the proposal, these employers would be relieved from testing for nondiscrimination if they make a base contribution for each eligible employee of 2 percent of pay (up to a maximum base contribution of $2,000). Employees could elect to contribute $4,238 (one-half the limit on elective deferrals under 401(k) plans). In addition, the employer could make matching contributions of up to 50 percent of the employees' contributions.

3. Simplify the administration of 401(k) and other plans. The proposal would simplify the rules for testing whether 401(k) plans provide proportionate benefits to lower paid employees by using the prior year's experience. As a related matter, the proposal would also simplify the definition of "highly compensated employee" for purposes of the employee benefit provisions of the Code and repeal the complex family aggregation rules. In addition, the proposal would enhance the IRS master and prototype program under which affordable standardized plans can be offered.

4. Make 401(k) plans generally available. Section 401(k) plans would be extended to employees of tax-exempt organizations and State and local governments.

5. Adopt a uniform vesting standard. The vesting requirements for multiemployer plans would be conformed to the existing requirements for single employer plans.

We are pleased to see that most of the areas targeted by the Administration's proposals are included in S. 1364, as well as in other pension simplification proposals pending before the Congress.

D. S. 1394, THE TAX SIMPLIFICATION ACT OF 1991

The Appendix to this testimony presents the views of the Administration on the specific provisions of S. 1394. We generally support the bill although some adjustments will be required to achieve revenue-neutrality before enactment. The Office of Tax Analysis estimates that, in its current form, S. 1394 is nearly revenue-neutral, with a loss of $89 million in fiscal 1992 and $47 million over the 5-year budget period (Table II). Certain of the proposals in S. 1394 will achieve significant simplification, but with significant revenue cost. In these instances, we have qualified our support as being subject to an acceptable revenue offset.

E. S. 1364, THE EMPLOYEE BENEFITS SIMPLIFICATION AND EXPANSION ACT OF 1991

We are encouraged by the similarities among the Administration's pension proposals, S. 1364, and the other pension simplification proposals that have been introduced in the Congress. These proposals all target the same basic areas where simplification is needed and areas where increased coverage should be encouraged. As the Administration's proposals demonstrate, it should be possible to fashion a revenue-neutral package to simplify the pension tax laws and expand coverage. We are ready to work with the Congress to move from this general consensus to enacted legislation.

Our review indicates, however, that S. 1364 in its current form would lose approximately $16 billion in revenue over the 5-year budget period. The Administration must oppose pension legislation that loses revenue. In addition, as noted in more detail in our comments on specific provisions, we have substantive policy concerns about certain provisions of the bill.

We believe, however, that simplification of the employee benefit provisions of the Code can be achieved within the parameters of the budget agreement. Simplification of these provisions, as well as expanded access to qualified retirement plans, is a desirable goal. Simplification legislation should not be a vehicle for altering fundamental retirement and tax policies. We also believe that such proposals should build on existing structures and thus minimize the complications inherent in any change to existing laws.

Our substantive comments on the provisions of S. 1364 are set forth in the remainder of my written statement.

TITLE I. NONDISCRIMINATION PROVISIONS

Definition of Highly Compensated Employees (Section 101)

Current law. The Code defines the term "highly compensated employee" to include any employee who during the current or preceding year (1) was a 5-percent owner, (2) earned over $90,803 (indexed) in compensation, (3) earned over $60,535 (indexed) in compensation and was in the top 20 percent of the employer's workforce by compensation, or (4) was an officer earning compensation over $54,482 (indexed) or was the highest paid officer, if no officer earned more than the stated amount. For the current year determination, only the 100 highest paid employees under this definition are taken into account. Current law permits certain employers to treat, on an elective basis, all employees earning over $60,535 (indexed) as highly compensated employees regardless of whether they are in the top 20 percent of the employer's workforce by compensation. In addition, for purposes of identifying highly compensated employees, certain family aggregation rules apply in the case of 5-percent owners and other highly compensated employees who are among the top 10 employees by compensation. Different family aggregation rules may apply for purposes of the limitation on compensation that may be taken into account under a qualified plan (section 401(a)(17)). These latter rules limit the family members required to be aggregated to the employee's spouse and lineal descendants under age 19.

Proposal. The proposal would redefine the term highly compensated employee to include only 5-percent owners and employees who earn over $60,535 (as indexed). If an employer had no highly compensated employees under this definition, then the one officer with the highest compensation would be treated as highly compensated, except for purposes of sections 401(k) and (m) (relating to elective deferrals, matching contributions and employee contributions). In addition, tax-exempt employers and state and local governmental employers would be exempt from the one-officer rule. The family aggregation rules would be limited to 5-percent owners.

Administration position. We support the proposal to simplify the definition of highly compensated employees. The elimination of the rules regarding officers and the top 20 percent of employees by compensation simplifies current law without sacrificing important policy objectives.

We oppose the exception to the one-officer rule that, under certain circumstances, would eliminate the requirement that at least one employee be treated as highly compensated. Such a proposal effectively eliminates the nondiscrimination rules for certain employers without providing any other mechanism to assure broad-based coverage.

Finally, we believe that the family aggregation rules are a source of great complexity and create inequities for two-wage-earner families where both spouses work for the same employer. Accordingly, we support simplification of those rules. However, we believe the rules could be further simplified by repealing them altogether as set forth in the Administration proposal released in April.

Modifications of Cost-of-Living Adjustments (Section 102)

Current law. Cost-of-living adjustments to various dollar limitations are currently made under adjustment procedures similar to those used for adjusting benefits under the Social Security Act. These cost-of-living increases under the Code are adjusted generally by using the last calendar quarter of a year and a base period of the last calendar quarter of 1986. Under this procedure, cost-of-living adjustments to the limitations in the Code are announced after the beginning of the year in which they are effective.

Proposal. The proposal would require the cost-of-living adjustment to be based on increases in the applicable index as of the close of the calendar quarter ending September 30 of the preceding calendar year. The proposal would also require that dollar amounts, as adjusted, be rounded to the nearest $1,000 (or to the nearest $100 in the case of the limitations on elective deferrals and in the case of the minimum compensation amounts applicable to SEPs).

Administration position. We support the proposal. It would permit the publication of applicable limits before the beginning of a calendar year for which they will be in effect and hence should assist plan administrators and plan participants. Similarly, the use of rounding would ease administration and employee communications.

Election to Treat Base Pay As Compensation (Section 103)

Current law. Current law contains a definition of compensation for purposes, among others, of applying the nondiscrimination rules to qualified plans (section 414(s)). In addition to the basic statutory definition, the Secretary is authorized to provide alternative methods for determining compensation for these purposes. The temporary regulations implement this authority in two ways, most significantly by permitting employers to elect to use any reasonable definition of compensation subject to satisfaction of a nondiscrimination test. Basic or regular rate of pay is not specifically authorized under existing regulations.

Proposal. The proposal would provide employers with an election to determine an employee's compensation solely by reference to base pay. If the employer made the election, it would apply with respect to all employees and for all relevant purposes. The election would be revocable only with the consent of the Secretary.

Administration position. During the comment period for the existing temporary and proposed regulations under section 414(s), employers discussed the possible addition of rate of pay as an alternative method for determining compensation. Alternative methods for determining compensation must be nondiscriminatory. We are carefully considering these comments for possible inclusion in the final regulations which we intend to publish in the very near future. We believe this can be accomplished under the existing regulatory authority and that legislation in this area will not be necessary. Moreover, we believe Congress should defer action until it has evaluated the final regulations. We are also concerned that the proposal would not require that the base pay definition meet any nondiscrimination standard.

Modification of Additional Participation Requirements (Section 104)

Current law. Qualified plans, including both defined benefit and defined contribution plans, are generally required to benefit the lesser of 50 employees or 40 percent of the employer's workforce.

Proposal. The proposal would exempt defined contribution plans from the minimum participation rules. The proposal would also modify the minimum participation rule by lowering the 50-employee threshold to 25 employees and by requiring an employer with 2 or more employees to cover at least 2 employees under the same plan. The bill would also permit employers to elect to have the new rules apply as if they had been included in the Tax Reform Act of 1986.

Administration position. We do not support the proposal. We doubt that it will be simplifying because it would generally permit employers to maintain a greater number of qualified plans with a smaller number of participants in each plan and will impose additional administrative burdens on the IRS. We particularly oppose the portion of the proposal that permits employers to elect a retroactive effective date.

Nondiscrimination Rules For Qualified Cash or Deferred Arrangements and Matching Contributions (Section 105)

Current law. Elective salary deferral contributions to a 401(k) plan are generally required to meet an actual deferral percentage (ADP) test. To satisfy the ADP test, the average of the deferral rates (expressed as a percentage of compensation) for each highly compensated employee eligible to participate in the plan generally may not exceed the greater of (1) 125 percent of the average of the deferral rates of all nonhighly compensated employees eligible to participate in the plan or (2) the lesser of (a) 200 percent of the average of the deferral rates of all nonhighly compensated employees eligible to participate in the plan, or (b) such average plus 2 percentage points. If a plan does not satisfy the ADP test for a year, excess deferrals by highly compensated employees must be either redistributed to them or recharacterized as after-tax contributions in order to retain the qualified status of the 401(k) plan. The distributions or recharacterizations are made on the basis of the respective portions of excess contributions attributable to each highly compensated employee.

If a plan permits after-tax employee contributions, or provides for employer contributions that are contingent on a participant's elective deferrals or after-tax employee contributions ("matching contributions"), the amount of such contributions generally must satisfy an actual contributions percentage (ACP) test. The ACP test is generally the same as the ADP test described above, except that it applies to matching and after-tax employee contributions rather than to elective deferrals. Rules analogous to the distribution rules under the

ADP test must also be followed if the ACP test is not satisfied. Restrictions are placed on the multiple use of the alternative limit (i.e., the 200 percent/2 percentage points test) in satisfying both the ADP test and the ACP test.

Proposal. The proposal would create certain safe harbors that would, in effect, deem either the ADP test or the ACP test, or both, to have been satisfied with respect to elective deferrals and matching contributions if the plan meets certain design and notice criteria. Under the bill, the ADP test would be deemed to have been satisfied if the plan either (1) provided matching contributions with respect to all nonhighly compensated employees equal to 100 percent of elective deferrals up to 3 percent of compensation and equal to 50 percent of elective deferrals between 3 and 5 percent of compensation or (2) provided nonelective contributions equal to at least 3 percent of compensation to all nonhighly compensated employees eligible to participate in the plan. In addition, certain alternative matching formulas would be allowed, subject to nondiscrimination requirements. Any contributions used to satisfy the safe harbor would be required to be fully vested and subject to the 401(k) restrictions on withdrawals. Furthermore, such contributions could not make use of the permitted disparity rules (section 401(l)). The safe harbor would also require the employer to provide notice, within a reasonable period before the beginning of a year, to all employees eligible to participate of their rights and obligations under the plan.

The ACP test would be deemed to have been satisfied with respect to matching contributions if the design and notice criteria relating to the ADP test were met and, in addition, (1) matching contributions were not made with respect to employee contributions or elective deferrals in excess of 6 percent of an employee's compensation, (2) the level of matching contributions did not increase with the level of employee or matching contributions, and (3) the rate of matching contributions at each level of compensation was no higher for highly compensated than nonhighly compensated employees.

Administration position. We oppose the provisions contained in the proposal providing alternatives to the ADP and ACP tests by allowing plans to satisfy nondiscrimination testing merely by making matching contributions available. This proposal represents a significant change in policy, not a simplification. We believe it would seriously erode current policies against discrimination in retirement plans because such a test would provide no assurance that benefits will be provided in fact to nonhighly compensated employees.

The current law ADP and ACP tests provide a clear incentive for employers to design a plan that is attractive to rank-and-file employees and to make every effort to communicate the plan to those employees, since the actual level of participation by those employees directly affects the permitted level of deferrals by highly compensated employees. By contrast, while the proposal that is under consideration at today's hearing would require notice of the plan to be given to eligible employees buttressed by penalties for failure to do so, it provides no affirmative incentive to provide benefits in excess of the statutory minimum. In fact, such a test is a disincentive to do so since, once the design-based criteria have been met, any additional participation by the nonhighly compensated employees will increase the cost of the plan to the employer.

As we have stated in the past, we believe that the principal sources of complexity in this area are not the basic ADP and ACP tests but rather the rules applicable to the distribution and recharacterization of excess deferrals and contributions. Thus, we believe that simplification of these rules -- not abandonment of the fundamental policy underlying these nondiscrimination rules -- should be the simplification objective in this area.

Accordingly, the Administration's pension proposal contained modifications to the ADP and ACP tests. Under our proposal, the ADP test would be modified such that each eligible highly compensated employee individually would not be permitted to defer more than a specified percentage of the deferral rates for the eligible nonhighly compensated employees for the preceding plan year. Corresponding changes were proposed with respect to the ACP test. In addition, the multiple use test was proposed to be repealed and recharacterization of excess deferrals as after-tax employee contributions would no longer be permitted. We believe the approach taken in the Administration's proposal would make the results of the ADP and ACP tests more predictable and would significantly reduce, if not eliminate, the likelihood of excess contributions. An employer would no longer need to monitor the average deferrals for the nonhighly compensated employees and the highly compensated employees during the current plan year in order to avoid the complicated correction mechanisms. Instead, the maximum contribution percentage for each highly compensated employee would be known at the beginning of the plan year. By minimizing the potential for excess contributions, the most significant source of complexity in 401(k) plans will be eliminated.

The Administration proposals will provide a design-based basic plan for small employers while continuing to make 401(k) plans generally available. Given the large growth in the popularity of such plans in recent years and the very real benefits provided to a broad base of employees, we believe that the better approach is to simplify the current 401(k) incentive structure -- not abandon it.

TITLE II. DISTRIBUTIONS

Taxability of Beneficiary of Employees' Trust (Section 201)

Current law. Distributions from qualified plans and other tax-preferred retirement programs are generally subject to income tax upon receipt. Premature distributions, generally those made before age 59½, may also be subject to a 10-percent additional tax. A number of special rules may alter the general rule if applicable.

Rollovers. Current income tax and, if applicable, the additional tax on a distribution can be avoided if the taxable portion of an eligible distribution is "rolled over" to another qualified plan or Individual Retirement Account (IRA). Only certain distributions (generally distributions that are either "qualified total distributions" or "partial distributions") are eligible for rollover treatment. As only the taxable portion of a distribution is eligible for rollover treatment, after-tax employee contributions may not be rolled over.

Lump sum distributions. Certain lump sum distributions are eligible to be taxed under special rules. These rules generally result in a lower rate of tax than would otherwise apply to a distribution. In general, a lump sum distribution is a distribution within one taxable year of the balance to the credit of the participant which becomes payable on account of death, separation from service, or disability, or after attainment of age 59½.

A participant or beneficiary generally may be able to elect to use the 5-year forward averaging rules with respect to a lump sum distribution if the distribution is received after age 59½. Five-year forward averaging is calculated under the tax rates in effect for the year of the distribution, and the election is available with respect to one distribution in an employee's lifetime. If a lump sum distribution is received before 1992, the recipient may also be able to elect to have the portion of the distribution attributable to pre-1974 plan participation taxed at capital gains rates.

Participants who attained age 50 before January 1, 1986, have three additional options which may reduce the rate of tax on a distribution. First, instead of using the 5-year forward averaging rules, they may continue to use the 10-year forward averaging rules available before the Tax Reform Act of 1986. Second, they may use the 5-year or 10-year forward averaging rules even if they are under the currently prescribed age requirement (age 59½) when they receive a distribution, if all of the other requirements for using those rules are met. Finally, they may elect to have the entire portion of a lump sum distribution attributable to pre-1974 participation taxed at a 20 percent rate.

If a lump sum distribution includes securities of the employer corporation, the net unrealized appreciation (NUA) in the employer securities is generally not subject to tax until the securities are sold, unless the recipient elects to have the normal distribution rules apply. When the securities are sold, the NUA is treated as long-term capital gain. If a distribution is not a lump sum distribution, only the NUA attributable to the employee's own contributions may be excluded from income under these special rules.

Proposal. Under the proposal, the 5-year forward averaging rules would be repealed with respect to distributions received in taxable years beginning after 1992. The current law treatment of NUA and the special averaging rules available to participants who attained age 50 before January 1, 1986, however, would be retained.

The bill would also simplify the rollover rules and permit any distributions to be rolled over. The current law restrictions on rollovers of after-tax employee contributions and minimum required distributions would be retained.

Administration position. We believe that the qualified plan distribution rules are an excellent candidate for simplification. However, we do not believe that significant simplification in this area will be achieved if the NUA exclusion and the preferential treatment available to taxpayers who attained age 50 before January 1, 1986 are retained. The Administration proposal to simplify the distribution rules would provide a single simple rule for distributions -- that such distributions either can be rolled over and deferred or are currently taxable. While preserving and enhancing an easily accessible deferral mechanism (i.e., rollover IRAs), such a rule would eliminate the need to evaluate multiple, complex alternatives on receipt of a distribution. Given the 1986 changes in the basic structure of the individual tax rates and brackets, the highly complex rules for forward averaging, NUA and capital gains treatment are no longer needed. The liberalized rollover proposal that is also contained in the Administration proposal should encourage employees to preserve their retirement savings.

While the proposal in S. 1364 adopts certain of the provisions contained in the Administration proposal, it adopts far fewer than will be required to fund the other changes set forth in the bill. The bill also loses significant revenue by permitting rollover of annuity payments. For these reasons, we oppose the proposal in its current form.

<u>Qualified Plans Must Provide For Transfers of Certain Distributions To Other Plans</u> (Section 202)

<u>Current law</u>. Current law places various restrictions on pre-retirement distributions from qualified plans. When a permissible distribution is made from a plan, it generally is made directly to the participant or beneficiary and is subject to income tax and, in the case of a premature distribution, a 10-percent additional tax. Under certain circumstances, the recipient of a qualified plan distribution can avoid current income taxation and any 10-percent additional tax by rolling the distribution over into another qualified plan or IRA. When making a distribution that is eligible for rollover treatment, plan administrators are required to provide a written explanation of the rollover rules to the recipient. The circumstances under which such rollovers are permitted under current law are limited, however, and the rules applicable to them are very complex. In addition, rollovers must be made within 60 days of the distribution. The burden of this complexity falls primarily on the individual participants.

<u>Proposal</u>. The bill would require qualified plans to make "applicable distributions" in the form of direct trustee-to-trustee transfers to an IRA or a qualified defined contribution plan that accepts such transfers as designated by the distributee. Applicable distributions would generally include any distributions permitted to be made by a plan over $500 that would have been subject to the 10-percent additional tax on early distributions if they have been distributed directly to the participant or beneficiary. Thus, exceptions to the required transfer provisions would be provided for certain distributions, including any distribution after the employee attains age 55 and distributions of employee contributions. The plan would be required to provide a method for designating the transferee plan where the distributee does not make a designation or where the transfer to the designated plan is not practical. The plan trustee would be required to provide a written notice to the participant of the transfer requirements and of the amount of the transfer. Similar rules would apply in the case of annuity plans and tax-sheltered annuities.

<u>Administration position</u>. We support the Administration proposal under which qualified plans would be required to give participants the option of having distributions that are eligible for rollover treatment transferred directly to an eligible transferee plan specified by the participant. We believe that it would accomplish the objectives of the similar provision in the bill without imposing a mandatory transfer not always desired by the plan participant. The Administration proposal would facilitate the rollover of pension benefits and the preservation of such benefits for retirement purposes without imposing any significant additional burdens on employers. Given the

availability of a better approach as described, we do not support the proposal in the bill in its current form.

The Pension Benefit Guaranty Corporation (PBGC) has advised us that the mandatory rollover requirement is not feasible for plans for which it is trustee.

Required Distributions (Section 203)

Current law. Under current law, distributions under most tax-preferred retirement arrangements must begin by no later than April 1st of the calendar year following the calendar year in which the participant attains age 70½, regardless of when the participant retires.

Proposal. The proposal would amend current law to return to the rule in effect prior to the changes made by the Tax Reform Act of 1986 and permit minimum required distributions to be delayed until retirement in the case of participants working after age 70½ provided an actuarial adjustment is made if no other benefits are accruing. Current law would continue to apply to 5-percent owners. Governmental plans and church plans would be exempt from the provisions retaining current law in specified instances and from the provision requiring actuarial adjustment.

Administration position. We would not oppose allowing a delay in required distributions until actual retirement except with respect to 5-percent owners, provided there is an acceptable revenue offset and that the actuarial adjustment required in the case of delayed distributions is fair and realistic. However, we oppose exempting governmental and church plans from the actuarial adjustment requirement. Employees covered under those plans should be entitled to the same protections as employees covered under other plans.

TITLE III. MISCELLANEOUS PROVISIONS

Treatment of Leased Employees (Section 301)

Current law. Section 414(n) of the Code provides that, for purposes of certain retirement and welfare benefit provisions of the Code, a leased employee is treated as an employee of the recipient of the leased employee's services. In order to be treated as a leased employee, a person must not be a common-law employee of the recipient and, in addition, must meet three requirements. First, the person must provide services to the recipient pursuant to an agreement between the recipient and a third-party leasing organization. Second, the person must provide the services to the recipient on a substantially full-time basis for at least one year. And, third, the services must be of a type historically performed by common-law employees in the business field of the recipient. Proposed regulations under section 414(n) were issued in 1987.

Proposal. The bill would eliminate the third requirement that the services be of a type historically performed by common-law employees in the business field of the recipient. In place of the "historically performed" standard, the proposal would substitute a requirement that the services be performed under the "control" of the recipient. The proposals generally would be retroactive to 1983.

Administration position. We would not oppose the objective of the proposal if effective prospectively and if an acceptable revenue offset is provided. We understand the intent is to limit section 414(n) to the abuses Congress originally sought to target when it enacted the section in 1983. As we have previously stated, we intend to withdraw those portions of the proposed regulations relating to the "historically performed" standard under section 414(n). We have deferred such action, however, pending Congressional revision of the standard to be applied in new regulations.

We believe that any new standard adopted by Congress should be clear in its application to specific cases. In this regard, we suggest that detailed examples in the legislative history be provided to demonstrate the intended application of the standard. "Control" in this context should not be determined by reference to employment tax concepts and should reflect the realities of the relationship, not merely its form.

Elimination of Half-Year Requirements (Section 302)

Current law. A number of employee benefit provisions, such as those relating to permissible and required distributions from qualified retirement plans, are based on the attainment of age 59½ or age 70½.

Proposal. Under the proposal, the half-year requirements would be eliminated so that each reference to age 59½ would become one to age 59 and each reference to age 70½ would become one to age 70.

Administration position. We do not oppose this proposal, although we question whether requiring such a change in plans would in fact be simplifying.

Plans Covering Self-Employed Individuals (Section 303)

Current law. Special employer aggregation rules apply to certain self-employed owner-employees participating in a tax-qualified retirement plan and controlling more than one business. The control group rules applicable to all employers under section 414(b) and (c) also apply to businesses controlled by self-employed owner-employees.

Proposal. The proposal would eliminate the special employer aggregation rules for self-employed owner-employees and would leave the generally applicable control group rules in place.

Administration position. We do not oppose the proposal provided an acceptable revenue offset is provided. The generally applicable control group rules should be sufficient to ensure against possible abuses with respect to plans maintained by self-employed owner-employees.

Full Funding Limitation of Multiemployer Plans (Section 304)

Current law. Under current law, an employer may generally make deductible contributions to a qualified defined benefit plan (including a multiemployer plan) subject to certain limitations, including the full funding limitation. The full funding limitation is generally the excess, if any, of the lesser of (1) 150-percent-of-current-liability or (2) the accrued liability (including normal cost) under the plan over the lesser of (i) the fair market value of the plan's assets or (ii) the value of the plan's assets determined under section 412(c)(2). Valuations of plan assets and liabilities are required at least annually.

The Secretary of the Treasury is granted regulatory authority to adjust the 150-percent figure to take into account the respective ages or lengths of service of the participants. In addition, the Secretary is granted regulatory authority to provide alternative methods based on factors other than current liability for the determination of the full funding limitation. The Secretary is to exercise this regulatory authority only in a revenue neutral manner. Because any such change would, by necessity, adversely affect some taxpayers and benefit other taxpayers, the Treasury Department has concluded that it will not exercise this authority unless directed by the Congress to do so.

Proposal. In the case of multiemployer plans, the proposal would amend current law to return to the rules in effect prior to the changes made by the Pension Protection Act of 1987. Thus, the 150-percent-of-current-liability prong of the calculation of the numerator of the full funding definition would be eliminated and valuations of multiemployer plans would be required only every 3 years.

Administration position. We oppose the proposal. A complete waiver for multiemployer plans of the 150-percent-of-current-liability prong of the full funding limitation involves substantial revenue loss. We do not believe that an exception to the generally applicable funding rules should be provided simply because the plan is a multiemployer plan.

Affiliation Requirements for Employers Jointly Maintaining a Voluntary Employees' Beneficiary Association (Section 305)

Current law. Under Treasury regulations, a voluntary employees' beneficiary association (VEBA) is not tax exempt under section 501(c)(9) of the Code if it benefits employees who do not share an employment-related common bond. An employment-related common bond generally exists only among employees of the same employer (or affiliated employers), employees covered by a collective bargaining agreement, members of a labor union, or employees of unaffiliated employers doing business in the same line of business in the same geographic locale. The IRS has interpreted the same geographic locale requirement as prohibiting a VEBA from covering nonunion employees of unaffiliated employers located in more than one state or metropolitan area. The same geographic locale requirement was held to be invalid by the 7th Circuit in Water Quality Ass'n Employees' Benefit Corp. v. United States, 795 F.2d 1303 (1986).

Proposal. The proposal would exempt VEBAs maintained by unaffiliated employers from the same geographic locale requirement if they (1) are in the same line of business, (2) act jointly to perform tasks which are integral to the activities of each of the employers, and (3) act jointly to such an extent that the joint maintenance of a voluntary employees' beneficiary association is not a major part of the employers' joint activities.

Administration position. We oppose the proposal in the bill; however, as discussed below, we would consider a more limited change to the VEBA rules. The same geographic locale requirement helps target the tax benefits available under section 501(c)(9) to organizations with the greatest need for support. The VEBA tax exemption was initially intended to benefit associations formed and managed by employees of a single employer or of small local groups of employers, to provide certain welfare benefits to their members in situations where such benefits would not otherwise have been available. Congress was concerned that such associations might not be viable without a tax exemption. By contrast, larger associations covering employees of unrelated employers in different geographic areas are more likely to be viable even without a tax exemption, and the benefits they provide are more likely to be able to be provided through commercial insurance.

The fact that unaffiliated employers would be required under the proposal to conduct certain joint activities does not address these concerns. Moreover, we are concerned that the nature and required level of joint activities under the proposal are so unclear that the exemption will apply to a large group of employers. This would have serious revenue consequences and, in addition, would undermine those provisions of the Code that prescribe the treatment of insurance companies.

Although we oppose the proposed exemption from the geographic locale requirement for the reasons stated above, we understand that the one-state or metropolitan area rule may be too restrictive in states or metropolitan areas with too few employees in the same industry to form an economical multiple-employer VEBA. An alternative to the proposal in the bill would be to limit VEBAs to a three-contiguous-state area, or a larger area if the Secretary determined that the employer group in the three-state area was too small to make self-insurance economical. If an acceptable revenue offset were provided, we would not oppose such a modification.

Treatment of Governmental Plans (Section 306)

Current law. Benefits payable under qualified defined benefit plans generally are limited to the lesser of $90,000 (indexed) or 100 percent of compensation (section 415). A number of circumstances may give rise to required adjustments to these limitations, including situations where benefits commence before age 62, in the case of a governmental plan, or where there is less than 10 years of service or participation in the plan. Under a special transition rule, government plans are permitted to elect to have pre-1988 limits apply with respect to qualified participants.

The basic definition of compensation under current law used to determine the limits on contributions and benefits is defined to conform as closely as possible to total taxable income received from the employer. Thus, salary reduction amounts excluded from an employee's gross income are not taken into account in determining compensation for this purpose.

Excess benefit plans of governmental employers providing benefits for certain employees in excess of the section 415 limitations on benefits and contributions under qualified plans are subject to the provisions of section 457, which include an annual cap on benefits of $7,500 (or, if less, 33-1/3 percent of compensation).

Proposal. The proposal would exempt benefits under governmental plans from the 100 percent of compensation limitation. The proposal would also exempt certain survivor and disability benefits under governmental plans from the adjustment for pre-age 62 commencement, and from the participation and service adjustments generally required to be made to the section 415 limitations on benefits.

For purposes of determining the limits on contributions and benefits under a governmental plan, the proposal would include certain salary reduction amounts in compensation. The proposal would exempt governmental excess benefit plans from the provisions of section 457. Finally, the proposal would permit a revocation of an election to have the pre-1988 limitations apply to qualified participants.

While the general effective date of the proposal is taxable years beginning after the date of enactment, the bill provides that plans are treated as satisfying the requirements of section 415 for all taxable years beginning before the date of enactment.

Administration position. We oppose the proposal creating an exception to the 100 percent of compensation limitation. The proposal would violate the long-standing policy against permitting benefits payable under qualified defined benefit plans to exceed 100 percent of compensation and does not present an appropriate case for making an exception to that policy.

We oppose the proposal creating a broad exception for survivor and disability benefits under governmental plans. We note, however, that certain pre-retirement survivor and disability benefits under governmental plans are not generally subject to the limitations on contributions and benefits under the current IRS interpretation.

We oppose the proposal to include salary reduction amounts in compensation for purposes of determining the limits on contributions and benefits under governmental plans. The proposal is inconsistent with the general policy that amounts excluded from gross income should not be taken into account for this purpose.

We oppose the excess benefit plan proposal. The scope of the proposal is narrowly drafted to cover only excess benefit plans maintained by one limited group of those employers subject to section 457.

We oppose the provision deeming all governmental plans to have satisfied the limits on contributions and benefits for all prior years. The proposal is in effect a retroactive repeal of those limits.

Modifications of Simplified Employee Pensions (Section 307)

Current law. Under current law, an employer may establish a simplified employee pension (SEP) that accepts elective salary reduction contributions. In order for a salary reduction SEP (SARSEP) to qualify, the employer generally may have no more than 25 nonexcludable employees, at least 50 percent of all nonexcludable employees must elect to make such contributions, and the deferral percentage of each eligible highly compensated employee must not exceed 125 percent of the average deferral percentage of all eligible nonhighly compensated employees (the "ADP" test). If an employer maintains a SEP or a SARSEP, the plan generally must be provided to all employees who are age 21 or older, who have performed service for the employer in at least 3 out of the last 5 years and who have received over $363 (indexed) in compensation.

Proposal. The proposal would permit employers with up to 100 nonexcludable employees to set up current law SARSEPs and would eliminate the 50-percent participation requirement. In addition, the proposal would exempt a SARSEP from the otherwise applicable ADP test if one of the design-based safe harbors provided under the bill with respect to 401(k) plans were adopted. Finally, the proposal generally would require SEPs of all types to cover every employee with at least 1 year of service.

Administration position. We oppose the proposal to eliminate the 50-percent participation test and to create an exemption from the ADP test applicable to SARSEPs without requiring any base contribution. The effect would be to eliminate any requirement that pension coverage be actually provided (as opposed to made available) to nonhighly compensated employees. Absent actual coverage of a broad base of employees, we believe that the substantial tax expenditure provided for pension arrangements cannot be justified.

In the Administration's pension proposal, we recommended a new vehicle for employers with 100 or fewer employees and no other retirement plan. Under our proposal, a base contribution would be made for each eligible employee of 2 percent of pay (up to a maximum base contribution of $2,000). Employees could elect to contribute up to one-half the limit on elective deferrals applicable to 401(k) plans and employers could make a 50 percent matching contribution. The minimum contribution concept embodied in the Administration's proposal would free small businesses from the burdens of experience-based testing, while at the same time ensuring broad-based coverage of nonhighly compensated employees.

Contributions on Behalf of Disabled Employees (Section 308)

Current law. An employer may make certain nonforfeitable contributions to a tax-qualified defined contribution plan on behalf of any disabled participant who is not highly compensated if an election is made.

Proposal. The proposal would permit nonforfeitable contributions to be made on behalf of highly compensated disabled participants for a fixed or determinable period and would waive the election requirement, if contributions were made on behalf of all disabled participants.

Administration position. We would not oppose the proposal if it were modified to insure that the provision does not operate in a manner that discriminates in favor of highly compensated employees and if an acceptable revenue offset is provided. We are concerned that, as presently drafted, contributions during disability could be provided for under a plan during years when the only disabled participants are highly compensated and such provisions could then be deleted in subsequent years when the only disabled participants were nonhighly compensated.

Distributions Under Rural Cooperative Plans (Section 309)

Current law. Distributions from 401(k) plans may be made upon attainment of age 59½, and distributions from profit-sharing plans may be made in certain events, including attainment of a stated age. Distribution from pension plans (including money purchase pension plans) generally must not commence until retirement.

Proposal. The proposal would permit distributions after attainment of age 59 from a money purchase rural cooperative plan which includes a 401(k) plan. Such distributions would not be limited to the 401(k) portion of the plan. The proposal is made retroactive, generally to 1987.

Administration position. We oppose the proposal insofar as it creates a retroactive special exception for a limited group of tax-qualified plans. We do not oppose the proposal if effective prospectively. However, we note that there would appear to be no impediment under current law for the rural cooperative plans to be converted to profit-sharing plans under which distributions upon the attainment of a stated age would be permissible.

Reports of Pension and Annuity Payments (Section 310)

Current law. Persons maintaining or administering certain tax-favored retirement arrangements are required to file reports in the nature of information returns regarding the arrangements with the IRS and with the participants, owners, or beneficiaries under the arrangements. Under current law, failure to file the reports is subject to specific penalties rather than the generally applicable penalty for failure to file information returns.

Proposal. Under the proposal, failure to file reports regarding tax-favored retirement arrangements that are in the nature of information reports would be subject to the generally applicable penalty for failure to file information returns.

Administration position. We support this proposal because conforming the information-reporting penalties that apply with respect to pension payments to the general information-reporting penalty structure will simplify the overall penalty structure through uniformity and provide more appropriate information-reporting penalties with respect to pension payments.

Tax-Exempt Organizations Eligible For Section 401(k) Plans (Section 311)

Current law. The Tax Reform Act of 1986 precluded tax-exempt employers from adopting 401(k) plans for their employees. Certain existing plans (i.e., plans adopted by tax-exempt employers before July 2, 1986) were grandfathered.

Proposal. Under the proposal, tax-exempt employers would be permitted to adopt 401(k) plans for their employees.

Administration position. We support the proposal subject to an acceptable revenue offset. We see no policy basis for precluding tax-exempt employers from adopting 401(k) plans for their employees. We believe this is also true with respect to State and local government employers as evidenced by the Administration proposal to expand 401(k) plans to those employers as well. There are, however, revenue costs associated with both proposals which have prevented enactment of these proposals in the past. If the Committee does not utilize the revenue-raising provisions proposed by the Administration, these cost constraints may again prevent implementation of this desirable change. We believe this is an appropriate way to encourage expanded pension coverage and to remove an exception to the general availability of 401(k) plans.

Date for Adoption of Plan Amendments (Section 312)

Current law. Plan amendments must generally be made by the end of the plan year in which the amendments are effective, although later amendments may be made if the remedial amendment period extends that date.

Proposal. The proposal would provide that any plan amendments required by the legislation would not be required to be actually made before the 1993 plan year, provided the plan is operated in accordance with the amendment and the amendment is made retroactive.

Administration position. We do not support this proposal. Absent appropriate circumstances, we believe a delayed date for actual plan amendments creates serious difficulties in the proper administration and operation of plans.

* * *

Mr. Chairman, that concludes my formal statement. I will be pleased to answer any questions that you or other Senators may wish to ask.

TABLE I

REVENUE ESTIMATES OF ADMINISTRATION'S PENSION PROPOSALS

	(billions) 1992	1992-96
Distributions from Qualified Plans	.6	3.0
Cash or Deferred Arrangements (401(k) Plans)	-.1	-.6
Extend 401(k)'s to Tax-exempts	-*	-.2
Extend 401(k)'s to State and Local Governments	-.1	-1.2
Salary Reduction Simplified Employee Pensions	-.1	-.8
Definition of Highly-Compensated Employee	*	.3
Repeal of Family Aggregation Rules	-*	-.1
Multi-Employer Vesting	-*	-.1
Total	.3	.3

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* Less than $50 million

The estimates assume an effective date of 1/1/92.

Department of the Treasury
Office of Tax Analysis

September 9, 1991

TABLE II

REVENUE ESTIMATE OF S. 1394
BY TITLE

	(millions) 1992	1992-96
Title I -- Individual tax provisions	-3	-41
Title II -- Large partnership provision	+3	+183
Title III -- Foreign provisions	+22	+87
Title IV -- Other income tax provisions	-103	-260
Title V -- Estate & gift tax provisions	-*	-*
Title VI -- Excise tax provisions	-11	-31
Title VII -- Administrative provisions	+3	+15
Totals	-89	-47

Department of the Treasury
Office of Tax Analysis

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APPENDIX TO STATEMENT OF KENNETH W. GIDEON BEFORE THE SUBCOMMITTEE ON TAXATION COMMITTEE ON FINANCE SEPTEMBER 10, 1991

This appendix presents in detail the views of the Administration on S. 1394, the Tax Simplification Act of 1991. The provisions are covered in the order in which they appear in S. 1394.

TITLE I. INDIVIDUAL TAX PROVISIONS

1. <u>Rollover of Gain on Sale of Principal Residence: Rules Relating to Multiple Sales Within Rollover Period</u> (Section 101)

<u>Current law</u>. No gain is recognized on the sale of a principal residence if a new residence at least equal in cost to the sales price of the old residence is purchased and used by the taxpayer as his principal residence within a specified period of time. This replacement period generally begins 2 years before and ends 2 years after the date of sale of the old residence. In general, nonrecognition treatment is available only once during any 2-year period. In addition, if during the replacement period the taxpayer purchases more than one residence which is used as his principal residence within 2 years after the date of sale of the old residence, only the last residence so used is treated as the new replacement residence. However, if residences are sold in order to relocate for employment reasons, two special rules apply: first, the number of times nonrecognition treatment is available during a 2-year period is not limited; second, if a residence is sold within 2 years after the sale of the old residence, the residence sold is treated as the last residence used by the taxpayer and thus as the only replacement residence.

<u>Proposal</u>. Gain would be rolled over from one residence to another residence in the order the residences are purchased and used, regardless of the taxpayer's reasons for the sale of the old residence. In addition, gain could be rolled over more than once within a 2-year period. Thus, the rules that formerly applied only if a taxpayer sold his residence in order to relocate for employment purposes would apply in all cases.

<u>Administration position</u>. The Administration supports this provision. The provision simplifies the application of section 1034 by amending it to provide a single set of rules for rollover of gain on the sale of a principal residence.

2. <u>Due Dates for Estimated Taxes of Individuals</u> (Section 102)

<u>Current law</u>. Individual estimated taxes for a taxable year must be paid in four installments, the due dates of which are April 15, June 15, and September 15 of that year and January 15 of the following year.

<u>Proposal</u>. The due date for the second installment of estimated tax would be changed from June 15 to July 15.

<u>Administration position</u>. We do not support this proposal. It entails a cost to the government, which would receive the second installment of estimated tax at a later date (thereby foregoing investment earnings on the funds or incurring interest expense on additional borrowings) and would have to revise tax forms and processing capabilities to accommodate the change. The proposal would not meaningfully simplify the law. The intervals between due dates for installments of individual estimated taxes would remain uneven; the 2-month interval that currently exists between the first (April 15) and second (June 15) installments would be replaced by a 2-month interval between the new second (July 15) and third (September 15) installments.

3. <u>Payment of Tax by Credit Card</u> (Section 103)

<u>Current law</u>. Payment of taxes may be made by checks or money orders, to the extent and under the conditions provided by regulations.

<u>Proposal</u>. The bill would permit payment of taxes by checks, money orders and other commercially acceptable means that the Secretary of the Treasury deems appropriate (including payment by credit card) to the extent and under the conditions provided by regulations. In addition, the Secretary would be given the authority to contract with financial institutions for credit card services at rates that are cost beneficial to the Government.

<u>Administration position</u>. The Administration supports these grants of authority. Allowing taxpayers to use credit cards to make tax payments would provide them with an additional option for payment that they have in most other debtor/creditor relationships. The proposal also allows flexibility to permit other commercially acceptable forms of payment.

4. <u>Election to Include Child's Income on Parent's Return</u> (Section 104)

<u>Current law</u>. The net unearned income of a child under 14 years of age is taxed at the marginal rate of the child's parents. If the child's gross income is solely from interest and

dividends and is more than $500 and less than $5,000, the parents may elect to report the child's gross income in excess of $1,000 on their return. If the election is made, in addition to the tax on the augmented income, the parents pay the lesser of $75 or 15 percent of the excess of the child's gross income over $500. For purposes of the alternative minimum tax (AMT), the AMT exemption of a child under the age of 14 is limited to the sum of the child's earned income and the greater of $1,000 or the unused parental minimum tax exemption.

Proposal. The dollar amounts relating to the election to include the child's income on the return of the parents would be indexed for inflation. In addition, the $1,000 amount used to determine the amount of the child's AMT exemption would be indexed for inflation.

Administration position. The Administration supports this provision. Adjusting for inflation for purposes of the election will prevent inflation from eroding the availability of the election over time. Because the election reduces the need to file separate returns for young children, preserving the availability of the election simplifies the filing process.

5. Certain Foreign Tax Credits for Individuals (Section 105)

Current law. In order to compute the foreign tax credit, a taxpayer computes foreign source taxable income, and foreign taxes paid, in each of the applicable separate foreign tax credit limitation categories. In the case of an individual, this requires the filing of Form 1116, designed to elicit sufficient information to perform the necessary calculations.

Proposal. On an elective basis, the proposal would eliminate the need for individual taxpayers with less than $200 in creditable foreign taxes to file a Form 1116 or to allocate and apportion expenses to their passive foreign source income reported on a Form 1099. In order to permit the simplified calculation, an electing taxpayer's credit would be limited to the lesser of 25 percent of such passive foreign source income or the total foreign taxes paid.

Administration position. We support this proposal. The bill would simplify the foreign tax credit computations for individuals claiming small amounts of credits.

6. Certain Personal Foreign Currency Transactions (Section 106)

Current law. When a U.S. taxpayer having the U.S. dollar as his functional currency makes a payment in a foreign currency, gain or loss (referred to as "exchange gain or loss") arises from any change in the value of the foreign currency relative to the U.S. dollar between the time the currency was acquired (or the obligation to pay was incurred) and the time that the payment is made. Gain or loss results because foreign currency, unlike the U.S. dollar, is treated as property for Federal income tax purposes. Exchange gain or loss can arise where foreign currency has been acquired for personal use.

Proposal. The bill would exempt from taxation exchange gains not exceeding $200 realized by individuals on the disposition of foreign currency in personal transactions. Losses on such transactions are not allowed under current law.

Administration position. We support this proposal. Taxpayers located abroad generally must conduct their affairs in the local currency. Under current law, taxpayers may be required to recognize exchange gains on dispositions of foreign currency in personal transactions. We agree that, in de minimis cases, this imposes unreasonable administrative demands on taxpayers, and that the insignificant amount of revenue collected from such transactions does not justify this administrative burden.

7. Due Date for Furnishing Information to Partners (Section 107)

Current law. Partnerships are required to furnish an information return (Schedule K-1) to each person who is a partner for any partnership taxable year on or before the day on which the return for such taxable year is required to be filed (April 15 for a calendar year partnership).

Proposal. A large partnership (which is a partnership with 250 or more partners or any partnership subject to the simplified reporting rules for large partnerships proposed in H.R. 2777) would be required to furnish information returns to its partners by the 15th day of the third month following the end of its taxable year (March 15, for a calendar year partnership).

Administration position. We support this proposal insofar as it applies to simplified Schedules K-1 issued by large partnerships as described in §201 of the bill. Information returns that are received on or shortly before April 15 are difficult for individuals to use in preparing their returns or computing their payments that are due on that date. It may thus be appropriate to accelerate this date in the case of large partnerships whose tax treatment is being modified (in Title II of this bill) in order to simplify the tax consequences of an investment in the partnership. We question, however, whether this requirement should be extended to partnerships which remain subject to detailed Schedule K-1 reporting or to Schedule K-1's issued to excluded partners of large partnerships.

8. Exclusion of Combat Pay from Withholding Limited to Amount Excludable From Gross Income (Section 108)

Current law. Gross income does not include certain pay of members of the Armed Forces. If enlisted personnel serve in a combat zone during any part of any month, military pay for that month is excluded from gross income. Special rules apply if enlisted personnel are hospitalized as a result of injuries, wounds, or disease incurred in a combat zone. In the case of commissioned officers, these exclusions from income are limited to $500 per month of military pay.

There is no income tax withholding with respect to military pay for a month in which a member of the Armed Forces is entitled to the combat pay exclusion. With respect to enlisted personnel, this income tax withholding parallels the exclusion: there is a total exemption from income tax withholding and total exclusion from income. With respect to officers, however, the withholding rule is not parallel: there is total exemption from income tax withholding, although the exclusion from income is limited to $500 per month.

Proposal. The proposal would make the income tax withholding exemption rules parallel to the rules providing an exclusion from income for combat pay.

Administration position. We support this proposal. The current differences between the withholding rules and the exclusion rules with respect to combat pay can lead to underwithholding on the pay of taxpayers (primarily officers) and could cause hardship at the time of the filing of their tax returns.

9. Simplified Income Tax Returns (Section 109)

Current law. The Treasury Department and the Internal Revenue Service (IRS) continually study ways to simplify reporting for individuals, both itemizers and nonitemizers.

Proposal. The bill would require the Secretary (or his delegate) to take such actions as may be appropriate to expand access to simplified individual income tax returns and otherwise simplify the individual income tax returns. The bill would mandate that the Secretary (or his delegate) submit a report no later than 1 year after enactment on such actions.

Administration position. We do not oppose this proposal. It mandates that the Treasury Department and the IRS continue existing and continuous activities to evaluate tax forms to make them easier to understand and to improve compliance. We do not believe a formal study should be required.

10. Rural Letter Carriers (Section 110)

Current law. A taxpayer may elect to use a standard mileage rate in computing the deduction allowable for business use of an automobile. Under this election, the taxpayer's deduction equals the standard mileage rate multiplied by the number of miles driven for business purposes, and is taken in lieu of deductions for depreciation and actual operation and maintenance expenses. If the taxpayer is an employee, the deduction is subject to the 2-percent floor on miscellaneous itemized deductions.

If the taxpayer's employer reimburses the taxpayer under an accountable plan for his actual expenses, the reimbursement is excluded from the taxpayer's income. A plan is accountable if it meets requirements of business connection, substantiation, and returning amounts in excess of expenses. Rather than requiring an employee to substantiate the actual amount of his expense, the employer can provide a mileage allowance. If a mileage allowance is paid at a rate not in excess of the standard mileage rate, the reimbursement is excluded from the taxpayer's income. If the mileage allowance is paid at a rate in excess of the standard mileage rate, the excess is included in the taxpayer's income (and is subject to reporting and withholding).

An employee of the U.S. Postal Service may use a special mileage rate equal to 150 percent of the standard mileage rate in computing the deduction for business use of an automobile in performing services involving the collection and delivery of mail on a rural route.

Proposal. The bill would repeal the special mileage rate for U.S. Postal Service employees. In its place, the bill would provide that the rate of reimbursement provided by the Postal Service to rural letter carriers under their 1991 collective bargaining agreement is considered to be equivalent to their actual expenses. This rate can be increased in the future by no more than the rate of inflation. The bill also would provide that the reimbursements are exempt from the accountable plan requirements.

Administration position. The Administration does not oppose the proposal insofar as it treats the reimbursements for automobile expenses provided to rural letter carriers as being equal to their actual expenses. The Administration believes, however, that the reimbursements should be subject to the accountable plan requirements. These requirements do not impose an undue burden on the Postal Service or rural letter carriers.

11. Exemption From Luxury Excise Tax For Certain Equipment Installed On Passenger Vehicles For Use By Disabled Individuals (Section 111)

Current law. The 1990 OBRA imposed a 10-percent excise tax on the portion of the retail price of a passenger vehicle that exceeds $30,000. The tax also applies to the installation of parts and accessories within 6 months of the date the vehicle is purchased.

Proposal. The bill would provide that the luxury excise tax does not apply to a part or accessory that is installed on a passenger vehicle after its purchase in order to enable or assist an individual with a disability to operate the vehicle or to enter or exit the vehicle by compensating for the effect of the disability. The tax would continue to apply to the portion of the retail price of the vehicle that exceeds $30,000, even if the purchaser is disabled and/or intends to make modifications to the vehicle that under the proposal would be exempt from the tax.

Administration position. We support the proposal. We would modify the proposed language slightly in order to clarify that Congress intends the proposal also to apply to structural or mechanical modifications to a vehicle that make the vehicle usable by a disabled person but that may involve the removal or rearrangement, rather than the addition, of parts.

We understand that the proposal is not intended to exclude from the luxury tax accessories such as cruise control, adjustable steering columns, power-adjustable seats, or power windows, door locks, mirrors or sunroofs that are commonly available as optional equipment from the manufacturer or dealer and that might assist any driver in operating the vehicle.

TITLE II. TREATMENT OF LARGE PARTNERSHIPS

A. General Provisions

1. Partnership Reporting System (Section 201)

Current law. A partnership generally is treated as a conduit for Federal income tax purposes. As a conduit, a partnership pays no tax. Instead, each partner takes into account a distributive share of the partnership's items of income, gain, loss, deduction, or credit. The character of an item allocated to a partner is the same as if it had been directly realized or incurred by the partner. The taxable income of a partnership to be allocated to the partners is computed in the same manner as that of an individual except that no deduction is permitted for personal exemptions, foreign taxes, charitable contributions, net operating losses, certain itemized deductions, or oil and gas percentage depletion. Some elections affecting the computation of taxable income derived from a partnership are made by the partnership, while others are made by each partner. The various limitations affecting the computation of taxable income and tax liability generally apply at the partner level, rather than at the partnership level.

Under the current reporting rules, each partnership must file a Form 1065, Partnership Return of Income, for each taxable year. The return is accompanied by a Schedule K-1 for each partner, reporting the partner's share of allocable tax items of the partnership, and other specified information. A copy of the Schedule K-1, or a suitable substitute, is furnished to each partner for use in reporting the items on the partner's income tax return. A partnership must separately state on each Schedule K-1 the partner's distributive share of each of several tax items that are specifically enumerated in the tax law. In addition, the K-1 must separately state the partner's distributive share of any partnership item that, if separately taken into account by the partner, could result in an income tax liability that differs from the liability that would result if the item were not stated separately.

In addition, section 704(c) and the "ceiling rule" thereunder require partnerships to take into account, in computing income, loss, gain and deduction, the difference between the contribution date basis and fair market value of property contributed to the partnership. The ceiling rule causes complexity and may preclude fungibility of interests in a large partnership. Second, current law provides that a constructive termination of a partnership for tax purposes occurs if, within a 12 month period, interests representing more than 50 percent of partnership profits and capital are sold or exchanged. In order to avoid constructive terminations, which can have negative effects, many large partnerships keep detailed records of transfers and impose transfer restrictions on their partners.

<u>Proposal</u>. The bill modifies the tax treatment of a large partnership (generally, a partnership with at least 250 partners) and its partners. Under the bill, as a general matter, the taxable income of a large partnership is computed in the same manner as that of an individual except that the number of items that would be reported to the partners is much more limited. As under current law, a large partnership would not be allowed a deduction for personal exemptions, net operating losses, or certain itemized deductions. All limitations and other provisions affecting the computation of taxable income or any credit (except for the at risk, passive loss and section 68 itemized deduction limitations, and any other provision specified in regulations) would be applied at the partnership and not the partner level. Thus, for example, any investment interest of the

partnership would be limited at the partnership level, and any carryover would be made at that level. All elections affecting the computation of taxable income or any credit would be made by the partnership. Except where inconsistent with the large partnership provisions, the rules of subchapter K would apply to large partnerships under the new system.

The bill provides that each partner takes into account separately the partner's distributive share of the following items: (1) taxable income or loss from passive loss limitation activities; (2) taxable income or loss from other activities (e.g., portfolio income or loss); (3) net capital gain to the extent allocable to passive loss limitation activities and other activities; (4) nèt alternative minimum tax adjustment separately computed for passive loss limitation activities and other activities; (5) general credit; (6) low-income housing credit; (7) rehabilitation credit; (8) for certain partnerships, tax-exempt interest; and (9) for certain partnerships, foreign tax credit information.

Thus, the bill would significantly reduce the number of potential items to be reported by large partnerships to their partners. We believe that in most cases the actual number of items to be reported would be no more than six. In order to accomplish that simplification, the bill would require changes in the treatment of certain items as explained in more detail below.

Capital gains. Under the bill, capital gains and losses of large partnerships would be netted at the partnership level. A partner in a large partnership would take into account separately his distributive share of the partnership's net capital gain. However, any excess of net short-term capital gain over net long-term capital loss would be consolidated with the partnership's other taxable income and would not be separately reported to the partners. Also, any excess of capital losses over capital gains would not be separately reported to partners; rather, that excess would be carried over indefinitely at the partnership level for use against future capital gains. A large partnership would not be allowed to offset any portion of capital losses against ordinary income.

The partnership's net capital gain would be allocated to passive loss limitation activities to the extent of net capital gain from sales and exchanges of property used in connection with such activities. Any excess would be allocated to other activities.

A large partnership's section 1231 gains and losses would be netted each year at the partnership level. Net gain would be treated as long-term capital gain and would be subject to the rules described above. Net loss would be treated as ordinary loss and consolidated with the partnership's other taxable income.

The netting approach provided in the bill for capital gain and loss and section 1231 gain and loss ensures that the basic rules for items are maintained, while simplifying reporting by placing most of the computational and compliance burden at the partnership level. Absent such an approach, additional items would have to be reported on the simplified 1099-K.

Deductions. The bill contains two special rules for deductions. First, unlike current law, miscellaneous itemized deductions are not separately reported to partners. Instead, an amount equal to 70 percent of those deductions is disallowed at the partnership level; the remaining 30 percent amount is allowed at the partnership level in determining taxable income. The allowable deduction amount is not subject to the 2 percent floor at the partner level. The 70 percent disallowance is intended to approximate the effect of the current law 2 percent floor at the partner level with respect to partnership deductions.

Second, also unlike current law, charitable contributions would not be separately reported to partners under the bill. Instead, the charitable contribution deduction would be allowed at the partnership level in determining taxable income, subject to the limitations that apply to corporate donors.

Credits in general. Under the bill, most credits, instead of being separately reported to the partners (as under current law), are consolidated at the partnership level into a general credit and then reported to partners as a single general tax credit item. As a general matter, the general credit includes all credits other than the low-income housing credit and the rehabilitation credit. A partner's distributive share of general credit would be taken into account as a current year general business credit. Thus, for example, the credits for clinical testing expenses and the production of fuel from nonconventional sources would be subject, at the partnership level, to the current law limitations on the general business credit. The refundable credit for gasoline used for exempt purposes would be allowed to the partnership, and thus would not be separately reported to partners.

In recognition of their special treatment under the passive loss rules, the low-income housing and rehabilitation credits would be separately reported to partners as under current law.

The bill imposes credit recapture at the partnership level and would determine the amount of recapture by assuming that the credit fully reduced taxes. Such recapture is applied first to reduce the partnership's current year credit, if any; the partnership is liable for any excess over that amount. Under the bill, the transfer of an interest in a large partnership (by a partner other than an excluded partner) would not trigger recapture of any credit.

Foreign tax credit. Elections, computations and limitations regarding the foreign tax credit generally would be made under the bill at the partnership level. Once determined at the partnership level to be allowable, the foreign tax credit would be reported to the partner as a general credit. For purposes of applying foreign tax credit limitations, the partnership would be treated as an individual subject to tax at a 25 percent rate. Excess credits could be carried forward at the partnership level but could not be carried back. The partner's distributive share of all items of income, gain, loss, or deduction would be treated as derived from sources within the United States.

Current law rules relating to the foreign tax credit would apply if the partnership were to elect to have them apply or if 25 percent or more of the gross income of the partnership during a taxable year were derived from sources outside the United States. In either case, the foreign tax credit would not be subjected to limitations at the partnership level or folded into the general credit. Instead, the partnership would separately report to its partners their respective shares of the partnership's foreign taxes, the source of partnership income, and the other partnership items the partners would need to compute the foreign tax credit at their level. As under current law, income from the partnership generally would be treated by the partners as passive for separate limitation purposes.

Tax-exempt interest. Under the bill, interest on a State or local bond would be treated as taxable (and thus not separately reported) unless at the end of each quarter of the taxable year at least 50 percent of the value of partnership assets consists of State or local bonds the interest on which is exempt from taxation. This rule reflects the judgment that apart from large partnerships organized for the purpose of holding State or local bonds, most large partnerships hold relatively small or no investments in those bonds.

Unrelated business taxable income. The bill retains current law treatment of unrelated business taxable income. Thus, a tax-exempt partner's distributive share of partnership items would be taken into account separately to the extent necessary to comply with the rules governing such income. The bill does not alter the rule that all income from a publicly traded partnership continues to be treated as unrelated business taxable income.

Passive losses. Under the bill, each partner in a large partnership would take into account separately the partner's distributive share of the partnership's taxable income or loss from passive loss limitation activities. The term "passive loss limitation activity" means any activity which involves the conduct of a trade or business (including any activity treated as a trade or business under section 469(c)(5) or (6)) and any rental activity. A partner's share of a large partnership's taxable income or loss from passive loss limitation activities would be treated as an item of income or loss from the conduct of a trade or business which is a single passive activity, as defined in the passive loss rules. Thus, a large partnership would not be required to separately report items from separate activities.

Each partner in a large partnership also would take into account separately under the bill the partner's distributive share of the partnership's taxable income or loss from activities other than passive loss limitation activities. Such distributive share is treated under the bill as an item of income or expense with respect to property held for investment. Thus, portfolio income (e.g., interest and dividends) is reported separately and is reduced by portfolio deductions and allocable investment interest expense.

Alternative minimum tax. Under the bill, AMT adjustments and preferences would be combined at the partnership level. A large partnership would report to partners a net AMT adjustment separately computed for passive loss limitation activities and other activities. In determining a partner's AMT income, the partner's distributive share of any net AMT adjustment would be taken into account instead of making separate AMT adjustments with respect to partnership items. Except as provided in regulations, the net AMT adjustment would be determined by using the adjustments applicable to individuals, and would be treated as a deferral preference for purposes of the section 53 minimum tax credit.

REMICs. For purposes of the tax on partnerships holding residual interests in REMICs, all interests in a large partnership would be treated as held by disqualified organizations. Thus, a large partnership holding a residual interest in a REMIC would be subject to a tax equal to the excess inclusions multiplied by the highest corporate rate.

Deferred sale treatment for contributed property. For all partners contributing property to a large partnership (including partners otherwise excluded from application of the large partnership rules, as described below), the bill replaces section 704(c) with a "deferred sale" approach. Under the bill, a large partnership would be treated as if it had purchased the contributed property from the contributing partner for its fair market value on the date of the contribution. The partnership, therefore, would take a contribution date fair market value basis in the property. The contributing partner's gain or loss on the contribution (the "precontribution gain or loss") would be deferred until the occurrence of specified recognition events. In general, the character of the precontribution gain or loss would be the same as if the property had been sold to the partnership at fair market value by the partner at the time of contribution. The contributing partner's basis in his partnership interest would be adjusted for precontribution amounts recognized under the provision. These adjustments generally would be made immediately before the recognition event.

The provision effectively would repeal the ceiling rule for large partnerships, i.e., the amount of precontribution gain or loss recognized by the contributing partner under the provision is not limited to the overall gain or loss from the contributed property recognized by the partnership, and the amount of depreciation allowable to the partnership is not limited to the contributing partner's precontribution basis in the property.

Under the bill, certain events occurring at either the partnership or partner level cause recognition of precontribution gain or loss. For example, the contributing partner's disposition of his partnership interest or the partnership's disposition of the contributed property, as a general matter, would cause recognition. Loss would not be recognized, however, by reason of a disposition to a person related (within the meaning of section 267(b)) to the contributing partner. Depreciation or amortization of the contributed property by the partnership also would cause recognition.

The contributing partner would recognize precontribution gain or loss as the partnership claims amortization, depreciation, or depletion deductions with respect to the property. The amount of gain (or loss) recognized would equal the increase (or decrease) in the deduction attributable to changes in basis of the property occurring by reason of its contribution. Any gain or loss so recognized would be treated as ordinary.

The contributing partner also would recognize precontribution gain or loss if the partnership disposes of the contributed property to a person other than the contributing partner. If such property were distributed to the contributing partner, its basis in the hands of the contributing partner would equal its basis immediately before the contribution, adjusted for any gain or loss previously recognized on account of the deferred sale. No adjustment is made to the basis of undistributed partnership property on account of a distribution to the contributing partner.

A contributing partner also would recognize precontribution gain or loss to the extent that the partner disposes of the partner's partnership interest other than at death. Such partner also would recognize precontribution gain or loss to the extent that the cash and fair market value of property (other than the contributed property) distributed to him exceeds the adjusted basis of his partnership interest immediately before the distribution (determined without regard to any basis adjustment under the deemed sale rules resulting from the distribution).

Section 754 election. The bill does not alter the rule that a large partnership may elect to adjust the basis of partnership assets with respect to transferee partners. The computation of a large partnership's taxable income is made without regard to the section 743(b) adjustment. As under current law, the section 743(b) adjustment is made only with respect to the transferee partner. In addition, a large partnership is permitted to adjust the basis of partnership property under section 734(b) if property is distributed to a partner, as under current law.

Terminations. The bill provides that a large partnership does not terminate for tax purposes solely because 50 percent of its profits and capital interests are sold or exchanged within a 12-month period.

Partnership allocations. The provisions of the bill do not affect the flexibility afforded to large partnerships to allocate tax items to their partners in any manner that has substantial economic effect or otherwise meets the requirements of section 704 of the Code.

Definition of large partnership. Under the bill, a "large partnership" is any partnership that has 250 or more partners during a taxable year. Any partnership treated as a large partnership for a taxable year would be so treated for all succeeding years, even if the number of partners falls below 250. The Secretary would be given authority to adopt regulations that would provide, however, that if the number of persons who are partners in any taxable year falls below 100, the partnership would cease to be treated as a large partnership. A partnership with at least 100 partners could elect under the bill to be treated as a large partnership. The election would apply to the year for which made and all subsequent years and could not be revoked without the Secretary's consent.

A large partnership would not include any partnership if substantially all of its activities involve the performance of personal services by individuals owning, directly or indirectly, interests in the partnership, or if 50 percent or more of the value of the partnership's assets consists of oil or gas properties as described below.

Treatment of excluded partners. In general, the large partnership rules would not apply to an excluded partner's distributive share of partnership items. An excluded partner is a partner (1) owning more than a 5 percent partnership profits or capital interest at any time during the taxable year, or (2) materially participating in the partnership's activities during the year and holding any interest which is not a limited partnership interest. Any partner treated as an excluded partner for a taxable year is so treated for all succeeding years. In determining whether a partner is an excluded partner, the treatment on the large partnership's tax return binds the partnership and the partner, but not the Secretary.

Treatment of partnerships holding oil or gas properties. Because of the rules relating to the percentage depletion deduction, the current treatment of oil and gas income of a partnership is difficult to approximate under the simplified reporting provisions of the bill. Therefore, the large partnership rules do not apply to a partnership if at least 50 percent of the value of its assets consist of oil or gas properties at any time during the taxable year. In addition, the rules do not apply to any item attributable to any partnership oil or gas property. However, an oil or gas partnership can elect to be treated as a large partnership. Further, partnerships owning oil or gas properties but which otherwise qualify as large partnerships (i.e., because less than 50 percent of their assets consist of oil or gas properties) can elect to apply the large partnership rules to items attributable to their oil or gas properties. If an election is made: (1) depletion is computed without regard to percentage depletion, (2) any partner who is an integrated oil company is treated as an excluded partner, and (3) any partner who holds a working interest in an oil or gas property (either directly or through an entity which does not limit the partner's liability) is treated as an excluded partner with respect to such interest. The election applies to the year for which made and all subsequent years and cannot be revoked without the Secretary's consent.

Regulatory authority. The Secretary of the Treasury is granted authority to prescribe such regulations as may be appropriate to carry out the purposes of the provisions.

Administration position. The Administration supports the bill's provisions modifying and simplifying the income reporting system for large partnerships. If the bill's simplified reporting regime is enacted, partners would receive a Form 1099-K that is much simpler and less intimidating than the present Schedule K-1. See Exhibit 1 attached. We anticipate that the IRS would require large partnerships to use a standard version of Form 1099-K. The ultimate result should be better compliance and lower costs to taxpayers. In addition, the new system would facilitate IRS matching of the information reported by a large partnership to its partners' returns. The ability to match information would be improved because (1) in most cases the number of items reported to each partner would be reduced, (2) each partner would be required to report each partnership item consistently with the partnership return, and (3) the bill would provide authority to the IRS to require each large partnership to provide Form 1099-K data to the IRS by magnetic media (see discussion below). With improved ability to monitor compliance, we believe the administration of large partnerships would be more efficient and fair. In addition, the adoption of the deferred sale rule for contributions of property and the elimination of the constructive termination rule will improve the tax rules applicable to large partnerships.

2. Large Partnership Audit System (Section 202)

Current law. Large partnerships currently are subject to the unified audit and litigation rules of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). The TEFRA rules are generally applicable to partnerships with more than 10 partners. Prior to TEFRA, regardless of the size of the partnership, adjustments to a partnership's items of income, gain, loss, deduction, or credit had to be made in a separate proceeding for each partner. When a partnership had partners located in different audit districts, actions against the partners of the partnership would frequently be brought in several different jurisdictions and sometimes would result in conflicting outcomes. The TEFRA audit rules were enacted to facilitate uniform results in audits of partnerships.

Under the TEFRA rules, a partner must report all partnership items consistently with the partnership return or must notify the IRS of an inconsistency. If a partner fails to report any partnership item consistently with the partnership return without notifying the IRS, the IRS may make a computational adjustment and immediately assess any additional tax that results.

The IRS may challenge the reporting position of a partnership by conducting a single administrative proceeding to resolve the issue with respect to all partners. But the IRS must still assess any resulting deficiency against each of the taxpayers who were partners in the year in which the understatement of tax liability arose.

Any partner of a partnership can request an administrative adjustment or a refund for his own separate tax liability. Any partner also has the right to participate in partnership-level administrative proceedings. As a general matter, there is no effective partnership level settlement process because each partner has the ability to enter into a separate settlement agreement.

The TEFRA rules establish the tax matters partner (TMP) as the primary representative of a partnership in dealing with the IRS. The TMP is a general partner designated by the partnership or, in the absence of designation, the general partner with the largest profits interest at the close of the taxable year. If no TMP is designated, and it is impractical to apply the largest profits interest rule, the IRS may select any partner as the TMP.

The IRS generally is required to give notice of the beginning of partnership-level administrative proceedings and any resulting administrative adjustment to all partners whose names and addresses are furnished to the IRS. For partnerships with more than 100 partners, however, the IRS generally is not required to give notice to partners whose profits interests are less than 1 percent.

After the IRS makes an administrative adjustment, the TMP (and, in limited circumstances, certain other partners) may file a petition for readjustment of partnership items in the Tax Court, the district court in which the partnership's principal place of business is located, or the Claims Court.

The IRS generally cannot adjust a partnership item for a partnership taxable year if more than 3 years have elapsed since the later of the filing of the partnership return or the last day for the filing of the partnership return.

Proposal. The bill would enact a new audit system for large partnerships. The bill defines "large partnership" the same way for audit as for reporting purposes (generally partnerships with at least 250 partners) except that large oil and gas partnerships which are excepted from the proposed reporting requirements are nonetheless subject to the proposed audit system.

A partnership adjustment generally would flow through to the partners for the year in which the adjustment takes effect. Thus, an adjustment that takes effect in a taxable year would be reflected in the distributive shares of partnership items of income, gain, loss, deduction, or credit allocated to the partners for that year. The adjustments generally would not affect prior year returns of any partners (except in the case of adjustments under section 704 of the Code with respect to partners' distributive shares). An adjustment will be offset by any related adjustment in a later year.

In lieu of flowing an adjustment through to its partners, the partnership may elect to pay an imputed underpayment. The imputed underpayment generally is calculated by netting the adjustments to the income and loss items of the partnership and multiplying the net amount by the highest individual or corporate tax rate. A partner may not file a claim for credit or refund of his allocable share of payment.

Under the bill, the partnership, rather than the partners individually, is liable for any interest and penalties that result from a partnership adjustment. Interest is computed for the period beginning on the return due date for the adjusted year and ending on the earlier of the return due date for the partnership taxable year in which the adjustment takes effect or the date the partnership pays the imputed underpayment. Penalties (such as accuracy-related and fraud) are determined on a year-by-year basis (without offsets) based on an imputed underpayment. All accuracy-related penalty and waiver criteria (such as reasonable cause, substantial authority, etc.) are determined as if the partnership were a taxable individual. Accuracy-related and fraud penalties are assessed and accrue interest in the same manner as if asserted against a taxable individual.

If a partnership ceases to exist before a partnership adjustment takes effect, the former partners are required to take the adjustment into account, as provided by regulations. Regulations are also authorized to the extent necessary to prevent abuse and to enforce the audit rules in circumstances that present special enforcement considerations. These situations would include partnership bankruptcy or a transfer of a partner's interest before an expected adjustment takes effect in order to avoid or reduce the tax liability that would result from the adjustment.

A partner is not permitted to report any partnership items inconsistently with the partnership return, even if the partner notifies the IRS of the inconsistency. The IRS could treat a partnership item that was reported inconsistently by a partner as a mathematical or clerical error and immediately assess any additional tax against that partner.

As under current law, the IRS could challenge the reporting position of a partnership by conducting a single administrative proceeding to resolve the issue with respect to all partners. Unlike current law, however, partners will have no right individually to participate in settlement conferences or court proceedings or to request a refund. The bill requires each large partnership to designate a partner or other person to act on its behalf. If a large partnership fails to designate such a person, the IRS is permitted to designate any one of the partners as the person authorized to act on the partnership's behalf. Under the bill, a large partnership would be permitted to designate a replacement for the person so designated by the IRS.

Unlike current law, the IRS is not required to give notice to individual partners of the commencement of an administrative proceeding or of a final adjustment. Instead, the IRS is authorized to send notice of a partnership adjustment to the partnership itself by certified or registered mail. The IRS could give proper notice by mailing the notice to the last known address of the partnership, even if the partnership had terminated its existence. As under current law, an administrative adjustment could be challenged in the Tax Court, the district court in which the partnership's principal place of business is located, or the Claims Court. However, only the partnership, and not the partners individually, can petition for a readjustment of partnership items.

Absent an agreement to extend the statute of limitations, the IRS generally cannot adjust a partnership item of a large partnership more than 3 years after the later of the filing of the partnership return or the last day for the filing of the partnership return. Special rules apply to false or fraudulent returns, a substantial omission of income, or the failure to file a return. The IRS would assess and collect any deficiency of a partner that arises from any adjustment to a partnership item subject to the limitations period on assessments and collection applicable to the year the adjustment takes effect.

Administration position. The Administration supports the simplified audit system for large partnerships proposed by S. 1394 because the system would provide a more efficient system to assess and collect tax deficiencies attributable to large partnerships and their partners. While we believe that the TEFRA rules continue to be appropriate for small and medium size partnerships, the emergence of large partnerships has strained the ability of the IRS to maintain a meaningful audit presence in this area. Consequently, a revised system designed for large partnerships is appropriate.

3. Magnetic Media Reporting (Section 203)

Current law. Under section 6011(e), the IRS has authority to require the filing of tax information in magnetic media or other machine-readable format, but only if the person files at least 250 "returns" during the year. Schedules K-1 are not returns, and accordingly the IRS may not require the use of magnetic media filing by large partnerships.

Proposal. Amend section 6011(e) to give the IRS authority to require filing in magnetic media or other machine-readable format for all partnerships with at least 250 partners.

Administration position. The Administration supports this provision. The IRS should have the authority to require magnetic media filing by partnerships with many partners. Other filers of large numbers of information returns are already required to file in this manner.

4. Effective Date (Section 204)

Proposal. The changes proposed in section 201-203 of S. 1394 with respect to large partnership reporting, large partnership audit procedures, and magnetic media reporting are proposed to be effective for partnership years ending on or after December 31, 1992.

Administration position. Given the significant changes proposed for large partnerships, sufficient lead time must be provided after enactment for the IRS and large partnerships to implement the legislation. We believe the effective date proposed will be sufficient if the proposals are enacted this year.

B. Partnership Proceedings Under TEFRA

As discussed above, TEFRA created unified audit and litigation procedures that are applicable to most partnerships. The TEFRA partnership provisions represented a significant positive change in the way that audits and litigation relating to partnerships and their partners were conducted. Thus, we are in favor of retaining these provisions with respect to partnerships that are not large partnerships under the bill and would otherwise fall within the scope of the TEFRA rules. Based upon the experience of the IRS in administering the TEFRA partnership provisions, however, we recognize that certain changes should be made to clarify and improve the procedures. Thus, with one exception relating to effective dates described below, the Administration supports the technical corrections and other simplifying amendments to the TEFRA partnership provisions that are contained in the bill. We believe that these changes will improve the operation and administrability of the TEFRA partnership provisions, which will benefit the partners in the partnerships as well as the IRS.

This section of the Appendix provides specific comments on the various amendments to the TEFRA partnership provisions that are contained in the bill. For the sake of convenience, some of the proposals have been grouped together and will be discussed under a common heading. Consequently, the proposals will not necessarily be addressed in the order that they appear in the bill.

1. Treatment of Partnership Items in Deficiency Proceedings (Section 211)

Current law. Adjustments to TEFRA partnership items must be made in a proceeding separate from a proceeding to adjust a taxpayer's nonpartnership items. While the two types of proceedings are separate, the result in one will affect the result in the other. Prior to the Tax Court's opinion in Munro v. Commissioner, 92 T.C. 71 (1989), it was IRS practice to compute deficiencies by assuming that all TEFRA items were correctly reported on the taxpayer's return. This practice proved unsatisfactory in situations where the taxpayer is oversheltered, i.e., where the losses claimed from TEFRA partnerships are so large that they offset any proposed adjustments to nonpartnership items, because no deficiency could arise from a non-TEFRA proceeding. Hence, when faced with this situation in Munro, the IRS issued a notice of deficiency to the taxpayer that presumptively disallowed the taxpayer's TEFRA partnership losses for computational purposes only. The Tax Court in Munro disapproved of the methodology used by the IRS to compute the deficiency and held that partnership items included on a taxpayer's return must be completely ignored in determining whether a deficiency exists that is attributable to nonpartnership items.

The opinion in Munro creates problems for both the IRS and taxpayers. In most of the cases that are either in litigation or under audit, net losses from TEFRA partnerships are claimed and used to partially offset income from non-TEFRA sources. Since under normal circumstances the TEFRA proceeding progresses more slowly than the deficiency proceeding, computing the deficiency under Munro will result in a greater deficiency being asserted in the deficiency proceeding than would have been asserted under IRS practice prior to the Munro opinion. Furthermore, while the methodology for computing deficiencies prescribed by Munro may solve the problem presented by the oversheltered situation, it creates a similar problem for the IRS in cases where a taxpayer's income is primarily from a TEFRA partnership and the IRS seeks to adjust nonpartnership items such as medical expense deductions, home mortgage interest deductions or charitable contribution deductions. Since under Munro the income would have to be ignored for purposes of the non-TEFRA proceeding, there would be no deficiency.

Proposal. The bill overrules the Munro case and provides a rule to allow the IRS to return to its prior practice of computing deficiencies by assuming that all TEFRA items whose treatment has not been finally determined were correctly reported on the taxpayer's return.

With respect to Munro-type cases, the bill provides a declaratory judgment procedure in the Tax Court for adjustments to an oversheltered return. An oversheltered return is a return that shows no taxable income and a net loss from TEFRA partnerships. In such a case, the IRS is authorized to issue a notice of adjustment with respect to non-TEFRA items, notwithstanding that no deficiency would result from the adjustments. However, the IRS may only issue such a notice if a deficiency would have arisen in the absence of the net loss from TEFRA partnerships.

The Tax Court is granted jurisdiction to determine the correctness of such an adjustment. Although no tax would be due upon such a determination, a decision of the Tax Court would be treated as a final decision, which would afford both the taxpayer and the IRS the right to pursue an appeal.

Administration position. We support this proposal. The approach required by the Tax Court in Munro causes problems for the IRS as well as taxpayers and is unworkable as a practical matter. The computations required by the Munro opinion are an administrative burden for the IRS because they are more complex and time consuming than normal deficiency computations. In addition, the effect of Munro in a typical case may be to deprive the taxpayer of a prepayment forum. As a policy matter, this result is an inappropriate and unintended consequence of an opinion dealing with a relatively unusual fact pattern. Overruling Munro and providing a declaratory judgment procedure constitute an appropriate solution.

2. Partnership Return to be Determinative of Audit Procedures (Section 212)

See discussion under Boundary Issues below.

3. Statute of Limitations (Section 213)

Current law.

(a) Untimely petition. Section 6229(d) provides in pertinent part that the running of the statute of limitations shall be suspended for the period during which an action may be brought under section 6226 and, if an action is brought during such period, until the decision of the court becomes final, and for 1 year thereafter. In a deficiency case, on the other hand, section 6503(a) provides in pertinent part that if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, the period of limitations on assessment and collection shall be suspended until the decision of the Tax Court becomes final, and for 60 days thereafter. As a result of this difference in language, the running of the statute of limitations in a TEFRA case will only be tolled by the filing of a timely petition,whereas in a deficiency case the statute of limitations is tolled by the filing of any petition, regardless of whether the petition is timely. Consequently, if an untimely petition is filed in a TEFRA case, the statute of limitations can expire while the case is still pending before the court.

(b) Bankruptcy. A partner's partnership items convert to nonpartnership items upon the filing of a petition naming the partner as a debtor in a bankruptcy proceeding. Section 6229(f) provides that the period for assessing tax with respect to items that convert to nonpartnership items shall not expire before the date which is 1 year after the date that the items become nonpartnership items. Section 6503(h) provides for the suspension of the limitations period during the pendency of a bankruptcy proceeding. However, this provision only applies to the limitations period provided in sections 6501 and 6502. Since the limitations period pertaining to converted items is governed by section 6229(f), there is some uncertainty concerning whether the suspension of the limitations period provided by section 6503(h) applies with respect to partnership items that convert to nonpartnership items by reason of the filing of a petition naming the partner as a debtor in a bankruptcy proceeding. As a result, the limitations period may continue to run during the pendency of the bankruptcy proceeding, even though the IRS is prohibited from making an assessment against the debtor because of the automatic stay imposed by section 362(a) of the Bankruptcy Code.

Likewise, if the IRS is unaware that the TMP has gone into bankruptcy, the IRS may mistakenly accept and rely on a consent to extend the statute of limitations on behalf of all partners in the partnership that was executed by the bankrupt TMP, which may be determined to be invalid because the debtor's status as TMP was automatically terminated by the filing of the bankruptcy petition. Hence, the IRS may be precluded from assessing any tax attributable to partnership item adjustments with respect to any of the partners in the partnership because of its detrimental reliance on a facially valid statute extension that subsequently proved to be invalid.

Proposal. With respect to untimely petitions, the bill amends section 6229(d) to make the language more consistent with section 6503(a). As a result, the TEFRA statute of limitations will be suspended by the filing of any petition, regardless of whether it is timely, as is the case with respect to the deficiency procedures.

With respect to the bankruptcy of a partner, the bill adds a provision similar to section 6503(h) to clarify that the statute of limitations is suspended during the pendency of a bankruptcy proceeding involving a partner in a TEFRA partnership.

Administration position. We support both of these proposals, subject to one reservation. As drafted, the provisions are retroactive to 1982. As a general rule, we do not favor retroactive legislation. Thus, we believe that the bankruptcy suspension provision should be effective for bankruptcy petitions filed after the date of enactment. However, it should be emphasized that this provision merely clarifies existing law and that no inference should be drawn from the prospective effective date regarding the applicability of the existing bankruptcy suspension provision to TEFRA cases. The untimely petition provision should similarly be prospective.

The provision regarding the suspension of the statute of limitations upon the filing of an untimely petition is a correction that is needed to close a gap in the statute. Similarly, the provision regarding the suspension of the statute of limitations upon the filing of a petition naming a partner as a debtor in a bankruptcy proceeding provides a much needed clarification of a very important issue. The ambiguity under current law makes it difficult for the IRS to adjust partnership items that convert to nonpartnership items by reason of a partner going into bankruptcy. In addition, the uncertainty often compels the IRS to seek relief from the automatic stay from the bankruptcy court so that the IRS can make an assessment with respect to the converted items. This provision will obviate the need for such action.

In addition, we believe that the bill should contain a provision dealing with the bankrupt TMP problem described above. This is of major concern to the IRS. In light of the growing number of bankruptcy filings, it is feared that this problem will occur with increasing frequency. To alleviate this problem, we recommend that the bill be amended to provide that, unless the IRS is notified of a bankruptcy proceeding in accordance with regulations, the IRS can rely on a statute extension signed by a person who would be the TMP but for the fact that said person was in bankruptcy at the time that the person signed the agreement. Thus, this proposal would place the burden on the partnership or the debtor to notify the IRS of any bankruptcy proceeding that involves the TMP. Otherwise, notwithstanding any other law or rule of law, any statute extensions granted by the bankrupt TMP shall be binding on all of the partners in the partnership.

4. <u>Boundary Issues</u> (Sections 212 and 214)

<u>Current law</u>. As noted above, adjustments to TEFRA partnership items must be made in a proceeding that is separate from a normal deficiency proceeding. When the IRS commences an audit, it must determine which procedure to use. This determination can be very technical and difficult to make, and the consequences of an incorrect choice can be severe. If the IRS applies the wrong procedure, the statute of limitations applicable to the correct procedure may have expired by the time that the problem is discovered. The situations giving rise to this problem are generally described as presenting "boundary issues."

A boundary issue arises in the context of the small partnership exception contained in section 6231(a)(1)(B). Pursuant to that section, the partnership audit provisions do not apply to a partnership that has 10 or fewer partners, each of whom is a natural person (other than a nonresident alien) or an estate, and each partner's share of each partnership item is the same as that partner's share of every other partnership item. Several pitfalls exist in applying this provision. Specifically, if an incorrect determination is made regarding whether there were ever more than 10 partners in the partnership at any one time during the year, or whether a person is a nonresident alien, or whether the same share rule is met during the year, the IRS may inadvertently apply the wrong procedures.

Proposal. The bill contains two provisions that are designed to alleviate boundary issue problems. Under the first provision, the IRS is permitted to rely on the partnership return to determine whether the TEFRA partnership procedures or the deficiency procedures should be followed. The second provision modifies the small partnership exception by eliminating the same share requirement and replacing the natural person requirement with a requirement that each partner must be an individual (other than a nonresident alien), a C corporation, or an estate of a deceased partner.

Administration position. Permitting the IRS to rely on the partnership's return to determine the proper procedure to apply should make it easier for the IRS to administer the tax laws by reducing the circumstances where the IRS must act at its peril in making what is often a difficult determination. A partnership should be permitted to have a C corporation as a partner or to specially allocate items without jeopardizing its qualification for the small partnership exception to the TEFRA rules. On the other hand, we believe that it is critical to retain the prohibition against a partnership having a flow-through entity such as another partnership, S corporation or trust as a partner for purposes of being excepted from the TEFRA procedures.

5. Partial Settlements (Section 215)

Current law. Section 6231(b)(1)(C) provides that the partnership items of a partner for a partnership taxable year shall become nonpartnership items as of the date the IRS enters into a settlement agreement with the partner with respect to such items. Under section 6229(f), the limitations period for assessing any tax attributable to converted items shall not expire before the date which is 1 year after the date on which the items become nonpartnership items. This rule creates a problem in situations where a settlement agreement is entered into with respect to some but not all of the issues in the case. The reason for this is that a 1 year assessment period will apply with respect to the settled items whereas the remaining items will be governed by the normal assessment period under section 6229(a). If issues are settled at several different stages of the proceeding, the problem can become severe.

Proposal. The bill provides that if a partner and the IRS enter into a settlement agreement with respect to some but not all of the partnership items in dispute for a partnership taxable year, the period for assessing any tax attributable to the settled items would be determined as if such agreement had not been entered into. Consequently, the limitations period that is applicable to the last item to be resolved for the partnership taxable year shall be controlling with respect to all disputed partnership items for the partnership taxable year.

Administration position. We support this provision. Under the bill, the limitations period that is applicable to the last item to be resolved for the partnership taxable year shall be controlling with respect to all disputed partnership items for the partnership taxable year. Thus, there will only be one statute of limitations to track and the IRS should only have to make one computation of tax with respect to each partner's investment in the partnership for the taxable year.

6. Administrative Adjustment Requests (Section 216)

Current law. Section 6227(a) provides that a partner may file a request for an administrative adjustment of partnership items within 3 years after the later of the date of the filing of the partnership return or the last day for filing the partnership return (determined without regard to extensions), but before the IRS mails a notice of final partnership administrative adjustment to the TMP. In contrast, section 6511(c), which applies with respect to a non-TEFRA case, provides that if an agreement is entered into under section 6501(c)(4) to extend the period for assessment, the period for filing a claim for credit or refund or for making a credit or refund if no claim is filed, shall not expire prior to 6 months after the expiration of the period within which an assessment may be made pursuant to the agreement under section 6501(c)(4). There is no comparable provision for extending the time for filing refund claims with respect to partnership items subject to the TEFRA partnership rules.

Proposal. The bill provides a rule for extending the time for filing refund claims with respect to partnership items subject to the TEFRA partnership provisions that is similar to the one in section 6511(c).

Administration position. We support this provision. The proposal is favorable to taxpayers and makes the TEFRA rules more consistent with the non-TEFRA rules. This should eliminate a trap for the unwary who mistakenly believed that, if the TEFRA statute of limitations was extended, they had additional time to file a request for administrative adjustment.

7. Innocent Spouse (Section 217)

Current law. Under section 6013(e), an innocent spouse may be relieved of liability for tax, penalties and interest if certain conditions are met. However, it is unclear whether existing law provides the spouse of a partner in a TEFRA partnership with a judicial forum to raise the innocent spouse defense with respect to any tax or interest that relates to an investment in a TEFRA partnership.

Proposal. The bill provides both a prepayment forum and a refund forum for raising the innocent spouse defense in TEFRA cases.

Administration position. We support this provision. We believe that it is appropriate to allow innocent spouse relief in TEFRA cases if the person would otherwise qualify for such relief.

8. Determination of Penalties at the Partnership Level (Section 218)

Current law. Section 6231(a)(3) limits the definition of partnership items to those items required to be taken into account under any provision of subtitle A. Since penalties are contained in subtitle F, they cannot be partnership items. Instead, penalties are treated as affected items that require partner-level determinations. As a result, under section 6230(a)(2), penalties may only be asserted against a partner through the application of the deficiency procedures following the completion of the partnership-level proceeding.

Proposal. The bill provides that the applicability of penalties shall be determined as part of the partnership-level proceeding and that the deficiency procedures will not apply to such a determination. However, the bill allows partners to raise any partner-level defenses in a refund forum.

Administration position. We support this provision. Penalty-only cases have created a significant burden for the IRS and have the potential of significantly increasing the Tax Court's inventory. Moreover, the requirement of conducting a separate proceeding with each partner greatly increases the likelihood of disparate treatment. Hence, the major goals of the TEFRA partnership provisions -- administrative and judicial economy and consistent treatment of partners -- are frustrated by separate penalty proceedings. The IRS believes that determining partnership-item adjustments and the penalties that are attributable to those adjustments in a single proceeding should greatly simplify the audit and litigation procedures for TEFRA partnerships. In the vast majority of cases, this proposal will eliminate the need to conduct affected item proceedings.

9. Jurisdiction of the Courts (Section 219)

Current law.

(a) Tax Court jurisdiction to enjoin premature assessments. Section 6225(a) provides a restriction on assessment and collection of any tax attributable to any partnership item during the 150-day period within which a petition could be filed in response to the mailing of a notice of final partnership administrative adjustment to the TMP by the IRS, and if a petition is filed in the Tax Court within the 150-day period, until the decision of the court becomes final. Section 6225(b) provides that, if any assessment or collection activity is taken in violation of the restriction described above, such premature action may be enjoined in the proper court. Current law is unclear regarding whether the Tax Court is a proper court for purposes of this section.

(b) Jurisdiction of courts to consider statute of limitations with respect to partners. Under sections 6226(c) and (d), in order for a partner other than the TMP to be eligible to file a petition for readjustment of partnership items or to participate in an existing proceeding, the period for assessing any tax attributable to the partnership items of that partner must not have expired. Since such a partner would only be treated as a party to the action if the statute of limitations with respect to that partner was still open, current law is unclear whether the partner would have standing to assert that the statute of limitations had expired with respect to themselves.

(c) Jurisdiction of Tax Court to determine overpayments attributable to affected items. Pursuant to sections 6511(g), 6512(a)(4), and 7422(h), the normal rules with respect to refunds in a non-TEFRA context do not apply with respect to overpayments attributable to partnership items. Instead, the rules set forth in sections 6227, 6228, and 6230(c) and (d) are controlling. Current law is ambiguous with respect to whether the rules that are applicable to overpayments attributable to partnership items also apply to overpayments attributable to affected items.

Proposal. The bill provides that the Tax Court has jurisdiction to enjoin premature assessment or collection activity but only in cases where it otherwise has jurisdiction over the partnership item adjustments giving rise to the tax liability at issue. The bill also clarifies that the Tax Court does have overpayment jurisdiction in an affected item proceeding. In addition, the bill permits a partner to be treated as a party to a partnership action solely for the purpose of litigating the statute of limitations question with respect to themselves and grants jurisdiction to the court that otherwise has jurisdiction over the action to consider the matter.

Administration position. We support these proposals. These proposals are all intended to clarify points that are unclear or ambiguous under current law and are akin to technical corrections.

10. Premature Petitions (Section 220)

Current law. Under section 6226(a), the TMP is given the exclusive right to file a petition for a readjustment of partnership items within the 90-day period after the issuance of a notice of final partnership administrative adjustment by the IRS. If the TMP does not file a petition within the 90-day period, section 6226(b) permits notice partners to file a petition within the succeeding 60-day period. Section 6226(b) also provides ordering rules for determining which action goes forward and provides for the dismissal of other actions if more than one petition is filed during the 60-day period.

If a petition is filed by a person other than the TMP during the 90-day period, that action is dismissed. Thus, if the TMP does not file a petition during the 90-day period and no timely and valid petition is filed during the succeeding 60-day period, judicial review of the adjustments set forth in the notice of final partnership administrative adjustment is foreclosed and the adjustments are deemed to be correct.

Proposal. The bill provides that in cases where the TMP does not file a petition within the 90-day period, if a petition is filed by a notice partner within the 90-day period and no valid and timely petition is filed within the succeeding 60-day period, then the premature petition shall be treated as if it were filed on the last day of the 60-day period.

Administration position. We support this provision. Unlike the situation in a deficiency case, there is no opportunity to seek judicial review under the TEFRA partnership provisions at a later date if a premature petition is dismissed and no valid and timely petition is filed during the 90-day or 60-day periods. We believe that dismissal of the premature petition under these circumstances is too harsh a result, although the rule should not encourage the filing of premature petitions. We believe that a proper balance is struck by reinstating a premature petition where the action would otherwise be dismissed, and that a premature petition should be treated as if it were filed on the last day of the 60-day period so as to take away any incentive to file early in an attempt to gain priority under the ordering rules set forth in section 6226(b).

11. Appeal Bonds (Section 221)

Current law. Section 7485(b) provides for the filing of a bond to stay assessment and collection during the pendency of an appeal in a TEFRA case. The amount of the bond is to be fixed by the Tax Court based upon its estimate of the aggregate amount of the deficiencies attributable to the partnership items to which the decision that is the subject of the appeal relates.

Proposal. The bill clarifies that the amount of the bond should be based on the aggregate liability of the parties to the action rather than of all the partners in the partnership. In addition, the bill makes it clear that the amount of the bond is to be based upon an estimate rather than on a precise calculation.

Administration position. We support this proposal. Current law is unclear concerning how the amount of the bond should be fixed by the Tax Court. By emphasizing that the amount of the bond should be based on an estimate and clarifying whose liabilities are to be covered by the bond, the Tax Court's job with respect to fixing the amount of the bond should be simplified. In this regard, we strongly believe that the amount of the bond should cover the aggregate liability of the parties to the action as opposed to merely the liability of the person posting the bond. Allowing each partner to post a separate bond for their respective liability would create a significant administrative burden for the IRS.

12. Restricted Interest (Section 222)

Current law. Section 6601(c) provides that, where a taxpayer executes a waiver of the restrictions on assessment of a deficiency under section 6213(d) and notice and demand for payment of such deficiency is not made by the IRS within 30 days after the filing of the waiver, interest will be suspended from the period immediately after the 30th day until the date of the notice and demand. The restricted interest provision is generally not applicable to TEFRA cases.

Proposal. The bill makes the restricted interest provision applicable to computational adjustments resulting from settlement agreements relating to partnership items.

Administration position. Extending the benefits of section 6601(c) to TEFRA cases that have been settled will make the computation of interest in deficiency cases and TEFRA cases more uniform. In addition, the proposal will make it simpler for the IRS to do interest computations in such cases, which under current law must frequently be done manually since interest is suspended only with respect to some aspects of a TEFRA case but not other parts of the case. Under this proposal, the restricted interest provision will apply with respect to the entire case.

TITLE III. FOREIGN PROVISIONS

1. Deferral of Tax on Income Earned Through Foreign Corporations and Exceptions to Deferral (Sections 301-305)

Current law. Under current law, a U.S. investor in a foreign corporation that earns passive income is potentially subject to six separate and distinct regimes that are designed to prevent him from improperly deferring his U.S. tax on income that is likely to bear little or no foreign tax. One of these regimes -- the Passive Foreign Investment Company (PFIC) regime -- itself consists of three separate sets of rules, because of taxpayer elections available to alter the timing and method of tax. These regimes are not only numerous; they are also complex and redundant. They impose excessive burdens on both taxpayers and the government in determining the correct U.S. tax liability for foreign-earned passive income. Two of the regimes were designed primarily to attack non-business-related accumulations by domestic corporations; they impose a penalty tax at the corporate level. The other four regimes were targeted specifically at accumulations by foreign corporations and apply at the shareholder level. These various regimes were enacted over a period of 60 years and are not adequately coordinated.

Proposal. The bill would consolidate the anti-deferral rules applicable to foreign corporations earning substantial amounts of passive income.

Administration position. We support the proposal in the bill as a substantial simplification of the current statutory scheme. Under the bill, taxpayers will no longer have to contend with the overlap and inconsistencies among the multiple regimes. Instead, shareholders will be taxed under a single integrated regime which provides one of three methods of tax, depending on the extent of U.S. ownership of the foreign corporation and whether its stock is publicly traded.

The single regime applies to passive foreign corporations (PFCs). A PFC is defined in a way that eliminates overlap and potential inconsistencies between the current PFIC and foreign personal holding company regimes. All shareholders of U.S.-controlled PFCs, and large shareholders and electing small shareholders of foreign-controlled PFCs, will be taxed currently under the existing Subpart F rules. This will cover most if not all of U.S. corporate participation in multinational enterprises. Non-electing small shareholders of foreign-controlled PFCs will pay tax annually on a "mark-to-market" basis if their PFC stock is publicly traded, and will be taxed under rules similar to the so-called "interest charge" rules of the current PFIC regime if their PFC stock is not publicly traded.

This proposal has been criticized recently by some commentators as failing to provide adequate simplification. I believe that these criticisms are misguided to the extent that they are aimed at defeating the proposal altogether. The statutory rules that the proposal would replace are extremely complex. It is not likely that they could be replaced by a provision that is not also complex. The literature on the interaction of the different anti-deferral regimes under current law is replete with complaints about the confusing interaction between these different regimes. The proposal addresses many of these complaints.

This is not to say, however, that the proposal cannot be improved. Many of the comments address technical concerns which we will work with the Committee to resolve. Still other criticize the proposals because they do not effect a fundamental revision in underlying policies. We question whether the benefits of simplification should be rejected given the uncertainties and delays inevitable in a more fundamental reexamination.

2. Modifications to Provisions Affecting Controlled Foreign Corporations (Section 311-313)

Current law. A United States shareholder is taxed currently on its pro rata share of a controlled foreign corporation's (CFCs) Subpart F income and is allowed a corresponding increase in its basis in the CFCs stock. When the CFCs earnings attributable to such Subpart F inclusions are later distributed, the dividends are excluded from the shareholder's income to avoid double taxation of the previously taxed amounts. A shareholder receiving the distributions is permitted to make special adjustments to allow it to claim credits for foreign taxes paid with respect to the distribution. If the United States shareholder sells its stock in the CFC, all or a portion of the gain on the sale may be recharacterized as a dividend; to the extent so recharacterized, the foreign tax credit rules apply, in many respects, as if the shareholder had received an actual dividend from the CFC.

Proposal. The bill contains a number of amendments to the rules for taxing U.S. shareholders of CFCs. In general, these amendments are aimed at reducing the possibility of excessive taxation of foreign earnings. In one instance the amendments would repeal (subject to transition rules) a provision that imposes substantial recordkeeping requirements on foreign corporations and their shareholders while conferring what appears to be a relatively minor benefit.

Administration position. We support these proposals as further implementing the existing general policy under Subpart F that the income of a CFC, having once been taxed to its United States shareholders, should not be taxed again. We note that the proposals give discretion to the Secretary in certain cases to take administrative or other concerns into account in implementing the proposals through the issuance of regulations. Although the proposed repeal of section 960(a)(3) may increase the tax burden on certain income earned through a CFC, we believe that this increased burden is likely to be minor (especially in view of the transition rules) and is outweighed by the substantial reduction in complexity.

3. Translation of Foreign Taxes into U.S. Dollar Amounts (Section 321)

Current law. Section 986(a) requires foreign taxes, paid in a foreign currency, to be translated into U.S. dollars for purposes of claiming a foreign tax credit at the exchange rate on the date of tax payment. Many U.S. multinationals have complained that the "date of payment" rule imposes a significant administrative burden, without promoting any substantial U.S. tax policy interest. The burden arises from the taxpayer's need, in many cases, to determine the foreign exchange rate for a very large number of separate tax payments made in different currencies on different dates, and then maintain appropriate records for these payments and exchange rates.

Proposal. The bill would give the Secretary the authority to permit use of an average exchange rate for an appropriate period, determined by regulation, rather than the exchange rate on the specific payment date.

Administration position. We support the bill's solution to this problem. Use of an average rate may not always be appropriate -- for example, in hyperinflationary currencies. The bill will permit us to write regulations providing sensible answers to practical problems, without reopening the policy debate settled by the 1986 Tax Reform Act.

4. <u>Foreign Tax Credit Limitation Under the Alternative Minimum Tax</u> (Section 322)

Current law. A U.S. taxpayer claiming a foreign tax credit must compute its taxable income from foreign sources as well as its overall, or worldwide, taxable income. Moreover, this computation must be done for each of several foreign tax credit "baskets" of income. To compute its foreign source taxable income within each of these baskets, the taxpayer must allocate and apportion its expenses. This procedure is complex and time-consuming, but it is fundamental to the correct operation of the foreign tax credit rules. In addition to these computations, a taxpayer may also be required to compute its foreign tax credit for alternative minimum tax purposes. Since taxable income for AMT purposes is different from taxable income for regular tax purposes, this requires a recomputation of foreign source taxable income, and therefore a reallocation and apportionment of expenses, in each of the foreign tax credit baskets.

Proposal. The bill would simplify the AMT foreign tax credit computation by permitting the taxpayer to elect to use its regular, rather than its AMT, foreign source taxable income in each of the baskets.

Administration position. We support the proposal. In many cases we believe that there will not be significant differences between a taxpayer's regular versus its AMT foreign source taxable income in the different baskets. Where there may be significant differences, the taxpayer need not elect the new rule. In this regard, it is important to note that the election must be made once, for all future taxable years. This is an appropriate limitation: it will prevent taxpayers from engaging in costly and complex computations of both AMT and regular foreign source taxable income each year to determine whether the election, in that year, would be cost effective.

TITLE IV. OTHER INCOME TAX PROVISIONS

A. S Corporations

1. <u>Determination of Whether an S Corporation Has One Class of Stock</u> (Section 401)

Current law. A corporation is not a small business corporation, and therefore cannot elect S corporation status, if the corporation has more than one class of stock. Differences in voting rights are disregarded in determining if a corporation has more than one class of stock and debt instruments meeting the requirements of a safe harbor are not treated as a second class of stock. The Code and legislative history do not provide any other guidance as to what may or may not constitute a second class of stock.

Proposal. A corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds. The determination of whether the outstanding shares of a corporation confer identical rights is made taking into account rights arising under the corporate charter, activities of incorporation or by-laws, legal requirements, administrative actions, and any agreements that are legally enforceable under state law. The provision does not limit IRS ability to properly characterize S corporation transactions for Federal income tax purposes.

Administration position. The Administration supports this provision. The provision clarifies the intended scope of the one class of stock requirement. New proposed regulations consistent with this provision have recently been issued.

2. Authority to Validate Certain Invalid Elections (Section 402)

Current law. S corporation status is not automatic for qualifying corporations. All of the shareholders of a small business corporation must consent to the election of the corporation to be an S corporation. The election may be made by a small business corporation for any tax year at any time during the preceding tax year or at any time on or before the 15th day of the third month of the current tax year. Any late election made after the 15th day of the third month is treated as an election for the following tax year. Moreover, where an election timely made during the current tax year is invalid for that year because one or more of the shareholders failed to consent to the election, or because the corporation had too many shareholders, an ineligible shareholder, or more than one class of stock, the election will be treated as having been made for the following tax year if the impediment is removed.

Proposal. The IRS would be given authority to waive the effect of an invalid election caused by the inadvertent failure to qualify as a small business corporation or to obtain the required shareholder consents. The IRS would also be authorized to validate an untimely election where the untimeliness is due to reasonable cause.

Administration position. The Administration supports this provision. It would allow the IRS to provide an administrative remedy for untimely or invalid elections in appropriate circumstances.

3. <u>Treatment of Distributions by S Corporations During Loss Year</u> (Section 403)

<u>Current law</u>. The total amount of a shareholder's portion of the losses and deductions of an S corporation may be taken into account by the shareholder only to the extent that the total does not exceed the basis of his stock and the basis of indebtedness owed to the shareholder by the corporation. Any loss or deduction that is disallowed may be carried over indefinitely.

Distributions by an S corporation generally are treated as a nontaxable return of capital to the extent of a shareholder's basis in his or her stock. The shareholder's stock basis is reduced, but not below zero, by the tax-free amount of the distribution. Any distribution in excess of the shareholder's basis is treated as a capital gain.

The basis of each shareholder's stock in an S corporation is increased by his or her pro rata share of certain items of income and decreased by his or her pro rata share of certain items of loss and deduction. Current law is unclear as to whether adjustments to basis for income, loss and deduction items must take place before or after adjustments for distributions. If the loss and deduction items reduce basis more than the income items increase basis, making such adjustments to basis before adjustments to basis are made for distributions would reduce the amount of the distributions that would be a tax-free return of capital. Such a result would be inconsistent with the partnership rules which provide that for any taxable year a partner's basis is first increased by items of income, then decreased by distributions, and finally decreased by losses.

A similar characterization problem arises with respect to distributions by S corporations with accumulated earnings and profits. Distributions by such corporations are treated: (1) as a nontaxable return of capital to the extent of the corporation's "accumulated adjustments account" (essentially the aggregate taxable income of the corporation for all years beginning after 1982 to the extent that such taxable income has not been distributed to shareholders), (2) as a dividend to the extent of the S corporation's accumulated earnings and profits, (3) as a nontaxable return of capital to the extent of the remaining basis of the shareholder's stock, and (4) as capital gain. For purposes of determining the effect of a distribution for any taxable year, adjustments reflecting the corporation's items of income, loss and expenses are made to the accumulated adjustments account in a manner similar to the adjustments required to be made to the shareholders' stock basis.

<u>Proposal</u>. The proposal would clarify that adjustments to basis for distributions during a year are made before adjustments to basis for items of loss. Accordingly, the extent to which

losses may be taken into account for a taxable year would be determined after the tax status of distributions has been determined.

In addition, if for any year an S corporation's items of loss and expense exceed its items of income, the adjustments that would otherwise be made to the accumulated adjustments account are disregarded in determining the effect of distributions made during the taxable year. This rule affects only distributions made by S corporations with accumulated earnings and profits.

Administration position. The Administration supports this provision. It would harmonize the basis adjustment provisions relating to partnership interests and S corporation stock and would provide a measure of certainty to shareholders of S corporations regarding the tax treatment of distributions made during loss years.

4. Treatment of S Corporations as Shareholders in C Corporations (Section 404(a))

Current law. An S corporation in its capacity as the shareholder of a C corporation is treated as an individual for purposes of subchapter C. In a private letter ruling, the IRS has interpreted this rule as preventing the tax free liquidation under section 332 and 337 of a C corporation subsidiary into an S corporation because a C corporation cannot liquidate tax-free when owned by an individual shareholder. However, the result desired by the taxpayer can be achieved on a tax-free basis by either having the S corporation purchase the C corporation and having the C corporation merge into the S corporation after the purchase or by having the S corporation lend money to its shareholders to purchase the C corporation who would then merge the C corporation into the S corporation.

Proposal. The bill would repeal the rule that treats an S corporation in its capacity as a shareholder of a C corporation as an individual.

Administration position. The Administration supports this provision. It would remove a trap for the unwary by treating the liquidation of a C corporation into an S corporation in the same manner as the merger of a C corporation into an S corporation or a conversion from C to S status. As is currently the case when a C corporation merges into an S corporation, the built-in gains of the liquidating C corporation would be subject to the built-in gains tax provisions of section 1374.

5. <u>S Corporations Permitted to Hold Subsidiaries</u> (Section 404(b))

<u>Current law</u>. Under current law, an S corporation may not be a member of an affiliated group of corporations. This limitation prevents an S corporation from owning stock in another corporation that possesses 80 percent or more of both the total voting power and value of the outstanding stock of the corporation.

<u>Proposal</u>. An S corporation would be allowed to own any amount, based on voting, value, or both, of the stock of a C corporation. In order to avoid the complexity of the consolidated return regulations, the S corporation parent would not be permitted to file a consolidated return with its subsidiaries.

<u>Administration position</u>. The Administration supports this provision if an acceptable revenue offset is provided. The current law restriction has caused many corporations either knowingly or inadvertently to terminate their S status or to adopt complex corporate structures to circumvent the restriction. The proposal achieves the desired objective of current law by directly preventing S corporations from filing consolidated returns.

6. <u>Elimination of Pre-1983 Earnings and Profits of S Corporations</u> (Section 404(c))

<u>Current law</u>. Prior to 1983, a corporation electing subchapter S status for a taxable year increased its accumulated earnings and profits to the extent that its undistributed earnings and profits for the year exceeded its taxable income. As a result of changes made in 1982 by the Subchapter S Revision Act, S corporations do not have earnings and profits for any year beginning after 1982. Under current law, a shareholder is required to include in income the pre-1983 accumulated S corporation earnings and profits when it is distributed by the corporation.

<u>Proposal</u>. If a corporation is an S corporation for its first taxable year beginning after December 31, 1991, the accumulated earnings and profits of the corporation (if any) as of the beginning of that year will be reduced by the accumulated earnings and profits that were accumulated in any taxable year beginning before January 1, 1983, for which the corporation was an electing small business corporation under subchapter S. Thus, any remaining earnings and profits of such a corporation would be solely attributable to taxable years for which an S election was not in effect.

Administration position. The Administration does not oppose this provision. We understand that the amounts being eliminated from earnings and profits are generally very small and do not justify the recordkeeping burden they create.

7. Determination of Shareholder's Pro Rata Share Where Disposition of Entire Interest (Section 404(d))

Current law. In general, the tax items passed through an S corporation to its shareholders are allocated among the shareholders on a per day, per share basis. If a shareholder terminates his or her interest in the corporation, the S corporation, with the consent of all persons who were shareholders at any time during the taxable year, may elect, for purposes of allocating tax items, to close the books of the corporation on the date of the termination of the shareholder's interest in the corporation.

Proposal. The bill would mandate that an S corporation close its books for purposes of allocating items of income on the termination of a shareholder's interest.

Administration position. The Administration supports this provision. It would assure a shareholder terminating his interest in an S corporation that his share of the corporation's income will not be affected by events occurring after the termination of his interest in the corporation.

8. Treatment of Items of Income in Respect of a Decedent Held By an S Corporation (Section 404(e))

Current law. Income items that would have been receivable by the decedent had he lived, and that are receivable by his estate or beneficiaries, are taxed to the estate or beneficiaries when received and retain the same character they would have had in the hands of the decedent. Such income is referred to as income in respect of a decedent (IRD).

Property which may produce IRD is not entitled to a basis step-up. IRD generated with respect to such property is not subject to income tax when received by the decedent's estate or beneficiaries. Under the partnership regulations, a partnership interest acquired from a decedent does not receive a basis step-up to the extent the fair market value of the interest reflects items of IRD. Thus, the IRD rules cannot be circumvented by contributing an IRD item to a partnership before death and receiving a full fair market value step-up for the partnership interest on the partner's death. There is no parallel provision for S corporation stock, however.

Proposal. The basis step-up at death for S corporation stock would be denied to the extent the fair market value of the stock represents IRD.

Administration position. The Administration supports this provision. It would prevent potential avoidance of the IRD rules by dropping items of IRD (e.g., an installment note) into an S corporation prior to death. The provision would be parallel to the existing rule for determining the basis of a decedent's partnership interest.

B. Accounting Provisions

1. Look-Back Method For Long-Term Contracts (Section 411)

Current law. Income from long-term contracts generally must be reported under the percentage of completion method of accounting (PCM). Under PCM, expected contract profit is recognized ratably, as costs are incurred, over the term of the contract. PCM includes look-back rules intended to compensate for deferral or acceleration of contract income resulting from use of expected (rather than actual) contract profit. Under the look-back rules, if actual contract profit is greater or less than expected profit, the taxpayer must pay, or is entitled to receive, interest. Look-back interest is computed when a contract is completed based on differences between expected and actual contract profits in each taxable year of the contract. It must be recomputed if contract profit changes because additional contract revenues or costs are taken into account after completion. Taxpayers are allowed (but not required) to discount post-completion adjustments to contract revenues and costs back to their value as of contract completion.

The rate used in computing look-back interest is the section 6621 overpayment rate. This overpayment rate equals the applicable Federal short-term rate plus 2 percentage points. The applicable Federal short-term rate is adjusted quarterly by the IRS. For any year of the contract, look-back interest runs from the due date of the return for that year without extensions (March 15 in the case of a calendar year corporate taxpayer) until the due date of the return for the year that the look-back is applied. Thus, to compute look-back interest for a particular year of the contract, a taxpayer is required to use 5 different interest rates for each 12-month period ending after the due date of the return for that year up through the return due date for the year that the look-back method is applied.

Proposal. The bill contains three proposals for simplifying the look-back method. The first two proposals would permit taxpayers to make a combined election under which they are not required to compute look-back interest for a contract, or to recompute look-back interest based on adjustments to contract price and costs, in certain de minimis cases. The third proposal would reduce the number of different interest rates that must be used to compute look-back interest.

If a taxpayer makes the election, the first proposal would provide that look-back interest is not computed for a long-term contract if the amount of deferral or acceleration of income from using estimates is not substantial. Thus, look-back interest is not computed if, for each year of the contract prior to the year of completion, the cumulative taxable income (or loss) from the contract as of the end of that year, determined using estimated contract price and costs, is within 10 percent of the cumulative taxable income (or loss) as of the end of that year using actual contract price and costs.

In addition, if a taxpayer makes the election, the second proposal would provide that look-back interest is not recomputed as a result of an adjustment to contract price or costs in a year after contract completion if the adjustment is not substantial. Thus, look-back interest is not recomputed because of an adjustment in a year after completion if the cumulative taxable income (or loss) from the contract as of the end of that year is within 10 percent of the cumulative taxable income (or loss) from the contract as of the most recent year in which the taxpayer was required to compute or recompute look-back interest (or would have been required to do so if the de minimis test provided by the first proposal had not been met).

The third proposal would generally fix the rate for calculating look-back interest for a 12-month period beginning on the due date of the taxpayer's return at the section 6621 rate for the calendar quarter that includes that date. Thus, in computing look-back interest for a particular contract year, the taxpayer would be required to use only one interest rate (rather than 5 different rates) for each 12-month period ending after the return due date for that year up through the return due date for the year that the look-back method is applied (determined without regard to extensions).

All three proposals apply to contracts completed in taxable years ending after the date of enactment.

Administration position. We support these proposals if an acceptable revenue offset is provided. Each responds to specific taxpayer concerns about the administrative burdens imposed upon taxpayers under current law. As we stated on other occasions we do not oppose de minimis rules similar to those that would be provided by the first two proposals. We believe that all three of these proposals would reduce the administrative burden imposed by the look-back method without undermining its purpose.

2. Uniform Cost Capitalization Rules (Section 412)

Current law. Generally, the uniform capitalization rules require taxpayers producing real or tangible property or acquiring property for resale to include in inventory the direct costs of the property and the indirect costs that are allocable to the property. Taxpayers are permitted to use various reasonable methods to determine the indirect costs that are allocable to production or resale activities, including certain simplified allocation methods provided in Treasury regulations.

Proposal. The proposal would authorize (but not require) Treasury to issue regulations providing for a simplified method for determining what part of the costs of administrative, service, or support functions or departments must be capitalized as part of the cost of property that a taxpayer produces or sells. The regulations, if issued, would permit allocation of these costs to production or resale activities by multiplying the total costs of any such function or department for the current taxable year by an historical ratio. The ratio would be the ratio of the total of such function or department's allocable costs that were allocable to property produced or acquired for sale during a "base period" to the function or department's total costs during the base period. The explanation prepared to accompany the proposal states that regulations, if issued, would provide that the base period could begin no earlier than 4 taxable years prior to the taxable year for which the simplified method is used. Although the proposal would be effective for taxable years beginning after the date of enactment, taxpayers could not use the simplified method for any taxable year beginning before Treasury publishes regulations.

Administration position. We do not oppose the proposal because it authorizes rather than requires such regulations. The Administration supports the goal of making compliance with the uniform capitalization rules less burdensome for taxpayers. However, we are not certain that we can devise rules which will adequately protect the fisc from loss due to distortion of income while meaningfully simplifying taxpayers' administrative burdens. We would not expect to propose regulations under this authority unless we were convinced, after appropriate investigation, that the regulations could meet a revenue neutrality constraint.

C. Minimum Tax Provisions

1. Corporate Minimum Tax Depreciation Preference (Section 421)

Current law. In computing the AMT depreciation deduction for personal property, taxpayers are generally required to use the

150 percent declining balance depreciation method over the ADR life of the property set forth in section 168(g). In computing adjusted current earnings (ACE), corporate taxpayers are generally required to compute the ACE depreciation deduction using the straight-line method over the ADR life.

Proposal. Under the proposal, corporate taxpayers generally would be required to use the 120 percent declining balance depreciation method in computing both AMT and ACE depreciation deductions for personal property placed in service in taxable years beginning after December 31, 1990 (using the same ADR recovery periods generally used for both AMT and ACE purposes under current law). The proposal would also permit corporate taxpayers to elect to calculate regular tax depreciation deductions using the same 120 percent declining balance method and recovery periods used in computing AMT and ACE depreciation deductions.

Administration position. We support the proposal provided an acceptable revenue offset is provided. We believe the proposal significantly simplifies the corporate AMT computation. Although the proposal loses revenue, there are some isolated instances in which taxpayers would be disadvantaged by the proposal (e.g., taxpayers with both current and cumulative negative ACE adjustments).

2. Treatment of Built-in Losses for Purposes of the Corporate Alternative Minimum Tax (Section 422)

Current law. For ACE purposes, if a corporation with a net unrealized built-in loss undergoes an ownership change, the adjusted basis of each asset must be restated to its fair market value immediately before the ownership change. This adjustment results in a permanent loss of asset basis for ACE purposes and creates an added complexity for certain taxpayers in computing AMT liabilities.

Proposal. The proposal would repeal the ACE asset basis restatement rule.

Administration position. We support the proposal provided an acceptable revenue offset is provided. Under current law, section 382 limitations apply to net operating losses and net unrealized built-in losses under both the regular tax and AMT systems. However, the ACE asset basis restatement rule results in needless complexity and inconsistency by departing from the general section 382 limitations which apply for regular tax and AMT purposes. The proposal would significantly reduce the recordkeeping requirements for affected taxpayers and provide for consistent application of the section 382 limitations to net unrealized built-in losses under each of the separate regular tax, AMT, and ACE systems.

D. Tax-Exempt Bond Provisions

1. Repeal of $100,000 Limitation on Unspent Proceeds Under 1-year Exception from Rebate (Section 431)

Current law. A tax-exempt bond is not subject to the arbitrage rebate requirement if all of the proceeds of the issue (other than proceeds in a reasonably required reserve and replacement fund and in a bona fide debt service fund) are spent for the governmental purpose of the issue within 6 months of the date of issue of the bond. In the case of non-private activity bonds and qualified 501(c)(3) bonds, the 6-month period is extended to 12 months if no more than the lesser of 5 percent of the proceeds of the issue or $100,000 is unspent after the first 6 months and such unspent amount is spent within the next 6 months.

Proposal. The condition that no more than the lesser of 5 percent or $100,000 remain unspent after 6 months would be changed to a requirement that no more than 5 percent of the proceeds remain unspent after 6 months.

Administration position. We support this proposal. We believe that this proposal will simplify compliance with this exception to arbitrage rebate without compromising tax policy with respect to the arbitrage rebate requirement.

2. Exception From Rebate for Earnings on Bona Fide Debt Service Fund Under Construction Bond Rules (Section 432)

Current law. Non-private activity bonds and qualified 501(c)(3) bonds issued to finance construction projects are exempt from the arbitrage rebate requirement if the bond proceeds are spent at specified percentages in 6-month intervals over a 24-month period beginning on the date of issue of the bonds. An issuer complying with the requirements of this exception under certain circumstances is still required to pay arbitrage rebate on arbitrage earnings attributable to a bona fide debt service fund.

Proposal. Earnings on a bona fide debt service fund, with respect to a bond issue that meets the spend-down requirements of the 24-month arbitrage rebate exception, would not be subject to the arbitrage rebate requirement.

Administration position. We support this proposal. We believe that this proposal will simplify compliance with the arbitrage rebate requirement and that it is consistent with the policy behind the 24-month arbitrage rebate exception.

3. Automatic Extension of Initial Temporary Period for Construction Issues (Section 433)

Current law. After the termination of the initial temporary period, bond proceeds invested at a yield materially higher than the yield on the bonds pursuant to such temporary period must generally be invested at a yield not in excess of the bond yield plus .125 percent.

Proposal. With respect to bonds issued to finance non-private activity construction projects, the initial temporary period would be automatically extended 1 year if, as of the end of the initial temporary period, the issuer had spent at least 85 percent of the bond proceeds available for construction and the issuer reasonably expected to spend the remaining bond-construction moneys within the following 12-month period.

Administration position. We do not oppose this proposal. We agree that subjecting bond proceeds to yield restriction and rebate requirements at the same time is duplicative and that simplification in this area is desirable. We believe that the proposal made last year by the Congressional staffs -- to allow issuers to rebate arbitrage in lieu of restricting yield on investments under appropriate circumstances -- continues to be the most promising approach. We suggest that this rebate-in-lieu-of-yield restriction proposal be given further consideration as a means of simplifying the problem addressed by the current proposal. We would, however, request that the Treasury be given regulatory authority to require yield restriction when necessary in order to discourage arbitrage-motivated transactions.

4. Aggregation of Issues Rules Not to Apply to Tax or Revenue Anticipation Bonds (Section 434)

Current law. The IRS in certain private letter rulings has treated multiple issues of bonds issued within 31 days of each other by the same issuer as being a single debt obligation for purposes of applying tax rules with respect to tax-exempt bonds. Tax and revenue anticipation notes (TRANs) are short-term borrowings by a governmental unit issued for the purpose of financing near-term cash flow deficits.

Proposal. The aggregation of TRANs with other non-private activity bond issues of an issuer would be prohibited regardless of when the TRANs was issued.

Administration position. We do not oppose this proposal. We believe that this clarification will simplify compliance with relevant Federal tax requirements without compromising Federal tax policy in this area.

5. Authority to Terminate Required Inclusion of Tax-Exempt Interest on Return (Section 435)

Current law. Section 6012(d) of the Internal Revenue Code requires that every person required to file a Federal income tax return for the taxable year must include on such return the amount of tax-exempt interest received or accrued during the year.

Proposal. The Secretary of the Treasury would be given authority to exempt taxpayers from reporting tax-exempt interest pursuant to section 6012(d) of the Code in any case in which the Secretary determines that the disclosure of such interest is not useful for tax administration.

Administration position. We do not support this proposal. Given the need for this data in tax administration, we see little likelihood that this authority could be exercised to reduce issuer compliance burdens in any significant way.

6. Repeal of Expired Provisions (Section 436)

Current law. A special exception to the arbitrage rebate requirement applicable to certain issues of qualified student loan bonds expired on December 31, 1988.

Proposal. Since the provision is no longer of any effect it would be repealed as deadwood.

Administration position. We support this proposal. The provision is no longer needed.

E. Revocable Trust Provision

Certain Grantor Trusts Treated As Estates (Section 441)

Current law. Many taxpayers use revocable trusts as substitutes for wills to avoid the costs of probate, for reasons of privacy and other nontax purposes. When a revocable trust becomes irrevocable on the grantor's death and thereafter effectively functions as an estate, it is taxed as a trust and is unable to take advantage of certain provisions of the Code that are available to estates but not trusts.

Proposal. The bill would amend section 7701 by adding a definition of an "estate". Under the provision, an estate is defined to include a pourover revocable trust, or, if there is no will, a trust that is primarily responsible for debts and administration expenses. Such a trust would not be treated as an estate for purposes of determining the trust's personal exemption or taxable year or for gift, estate or generation-skipping tax purposes. Treasury would have regulatory authority to prescribe additional exceptions. Such a trust would be treated as an estate for taxable years that begin within 3 years and 9 months of the decedent's death.

Administration position. The Administration does not oppose this provision of the bill. The purpose of the provision is to eliminate several of the tax disincentives to using funded revocable trusts as substitutes for wills. The bill would simplify planning by reducing the tax considerations in deciding whether to use a revocable trust.

F. Other Provisions Relating to Partnerships

1. Timing Rules for Inclusion and Deduction of Partnership Guaranteed Payments (Section 442)

Current law. Under section 707(a) a partner who engages in a transaction with a partnership other than in his capacity as a partner is treated as if he were not a member of the partnership with respect to the transaction. Examples of such transactions include loans of money or property by the partnership to the partner or by the partner to the partnership, the sale of property by the partner from the partnership, the purchase of property by the partner from the partnership, and the rendering of services by the partnership to the partner or by the partner to the partnership. Transfers of money or property by a partner to a partnership as contributions, or transfers of money or property by a partnership to a partner as distributions, are not transactions within the purview of section 707(a).

Under section 707(c), the payments made by a partnership to a partner for services or for the use of capital (i.e., "guaranteed payments") are considered as made to a person who is not a partner to the extent the payments are determined without regard to the income of the partnership. Guaranteed payments are considered as made to one who is not a member of the partnership only for purposes of section 61(a) (relating to gross income) and section 162(a) (relating to trade or business expenses).

Section 267 sets forth certain timing rules relating to deductions for losses, expenses and interest arising from transactions between related taxpayers. As a general matter, section 267(a)(2) provides that in transactions between related parties, payments are deductible by a taxpayer only when they are includible in the income of the person to whom payment is made. Section 267(e) extends this rule to transactions between partnerships and their partners except with respect to a partnership's guaranteed payments. Instead, a partner must include such payments as ordinary income for his taxable year within or with which ends the partnership taxable year in which the partnership deducted the payments.

Proposal. The bill would defer the deduction of a guaranteed payment by a partnership until the year in which it is includible in the partner's income. Thus, the bill conforms the timing rule for guaranteed payments to the timing rule for payments made to a partner acting in a capacity other than as a member of the partnership.

Administration position. The Administration supports this proposal. It is desirable to have the same timing rule for payments made by a partnership to a partner either as payments made not in the partner's capacity as a partner or as guaranteed payments, since these types of payments can be difficult to distinguish from each other.

2. Closing of Partnership Taxable Year With Respect To Deceased Partner (Section 443)

Current law. A partner reports his share of items of income, gain, loss, deduction, and credit on his return for the year in which or with which the partnership's year ends. The taxable year of a partnership closes with respect to a partner who sells or exchanges his entire interest in the partnership, or whose entire interest in the partnership is liquidated other than by reason of death. Thus, a partner who sells his entire interest reports his share of partnership items for the year that includes the date of sale on his income tax return for the year that includes the date of sale (and not on his return for the year in which the partnership's year would normally have ended). Because the partnership's year does not end by reason of the death of a partner, a decedent-partner's share of partnership items for the partnership year that includes his death is reported on the estate's return rather than on the decedent's final return. However, the partnership's year would close with respect to the decedent-partner if his entire interest is sold pursuant to a buy-sell agreement existing at the time of death. In such a case, the decedent-partner's share of partnership items for the partnership year that includes his death would be reported on his final return rather than the estate's return.

Proposal. The bill would provide that the taxable year of a partnership closes with respect to a partner whose entire interest in the partnership terminates, whether by death, liquidation, or otherwise.

Administration position. We support this proposal. The year closing result should not be dependent on the presence of a buy-sell agreement.

G. Corporate Provision

Clarification of Amount of Gain Recognized by a Securityholder in a Reorganization (Section 444)

Current law. In general, a holder of corporate stock or securities who exchanges them for other stock or securities in a corporate reorganization or "spin-off" does not recognize gain even if the holder realizes gain because the value of the stock or securities received exceeds the holder's basis in the stock or securities given up. This general rule does not apply, however, if the principal amount of securities received exceeds the principal amount of securities given up. In this case, any gain realized on the exchange is recognized up to the fair market value of the excess principal amount. It is not clear how the "principal amount" of a security surrendered or received in a reorganization is measured for this purpose. Under the original issue discount (OID) rules of current law, however, that portion of the stated principal amount of a bond that exceeds the issue price of the bond is treated as unstated interest that is included in income by the holder and deductible by the issuer over the term of the bond.

Proposal. The proposal would coordinate the "excess principal amount" rule with the OID rules of current law. Thus any portion of the stated principal amount that is treated as unstated interest under the OID rules would not be treated as principal for purposes of determining how much gain is recognized in a reorganization. Instead, the issue price of the securities received, and the adjusted issue price of the securities surrendered, would be treated as their principal amount. In contrast to current law, under which the amount of gain recognized is based on the fair market value of the excess principal amount of the securities received, the proposal would not require determination of the fair market value of this excess.

Administration position. We support this proposal. It will provide similar tax treatment for exchanges that are similar in economic substance.

TITLE V. ESTATE AND GIFT TAX PROVISIONS

1. Waiver of Right of Recovery for Certain Marital Deduction Property (Section 501)

Current law. A marital deduction is allowed for estate and gift tax purposes for qualified terminable interest property (QTIP) that passes to a spouse. The property is generally includible in the estate of the spouse beneficiary. The estate of a spouse beneficiary of a QTIP trust has a right of recovery against the person receiving the trust property for estate taxes attributable to the inclusion of the trust in the spouse's gross estate. The right of recovery may be waived by the spouse beneficiary in his or her will.

Proposal. The bill would provide that the right of recovery may be waived by the spouse beneficiary only by a specific reference to section 2207A.

Administration position. The Administration does not oppose this proposal. The proposal does not affect the substantive right of the surviving spouse to waive the right of recovery. By establishing a clear test for what constitutes an effective waiver under section 2207A, the provision should prevent the inadvertent waivers that sometimes occur under current law.

2. Inclusion in Gross Estate of Certain Gifts Made Within Three Years of Death (Section 502)

Current law. Generally, transfers made within 3 years of death are not includible in the transferor's gross estate. However, the transfer within 3 years of death of certain retained rights with respect to previously transferred property causes the entire property to be includible in the transferor's gross estate. This inclusion rule applies to transfers made from a revocable trust within 3 years of the transferor's death. This may cause, among other things, annual exclusion gifts made from the revocable trust during that period to be includible in the transferor's gross estate.

Proposal. The bill would amend section 2038, which deals with revocable transfers, to ensure that transfers made from an individual's revocable trust within 3 years of the individual's death are not includible in the individual's gross estate. The bill would also restate section 2035, which generally deals with the inclusion in the gross estate of property transferred within 3 years of death, for greater clarity without substantive change.

Administration position. The Administration does not oppose this provision of the bill. Funded revocable trusts are created by individuals for a variety of legitimate, nontax planning purposes. The inability to use the revocable trust as a vehicle for making annual exclusion gifts without estate tax exposure is a significant tax disadvantage to the use of such trusts.

3. Definition of Qualified Terminable Interest Property (Section 503)

Current law. A marital deduction is allowed for estate and gift tax purposes for a QTIP passing to a spouse. For property to qualify as QTIP, the beneficiary spouse must have a qualifying income interest for life in the transferred property; i.e., must be entitled to all the income from the property, payable at least annually. Proposed Treasury regulations provide that income accrued or accumulated between the last income distribution date and the date of the spouse's death does not have to be payable to the spouse or the spouse's estate for the spouse to have a qualifying income interest for life. In Estate of Howard, 91 T.C. 329 (1988), rev'd, 910 F.2d 633 (9th Cir. 1990), the Tax Court held that this "stub period" income must be payable to the spouse's estate or be subject to the spouse's general power of appointment for the spouse to have the requisite income interest. Although the Howard decision was reversed on appeal, it is unclear how the Tax Court would rule if the question arises in a case appealable to another circuit.

Proposal. The bill would provide that an income interest would not fail to be a qualifying income interest for life solely because the stub period income is not payable to the spouse's estate or subject to the spouse's general power of appointment. If the marital deduction is allowed, however, such income would be includible in the spouse's estate.

Administration position. The Administration supports this provision of the bill. The codification of the proposed Treasury regulation will eliminate the need for the closing agreement procedure now used by the IRS to permit taxpayers who have relied on the proposed regulation to claim the marital deduction while protecting the government against the potential whipsaw of avoiding subsequent inclusion of the trust property in the spouse's estate on the grounds that the deduction was improperly allowed.

4. Requirements for Qualified Domestic Trust (Section 504)

Current law. Generally, property passing to a noncitizen surviving spouse does not qualify for the marital deduction unless it passes in a qualified domestic trust (QDT). Distributions of principal from such a trust to the surviving spouse are subject to estate tax. When originally enacted, the QDT provisions required that all trustees of a QDT be U.S. citizens or domestic corporations. This provision was retroactively amended twice and ultimately required that the trust must provide that no distributions can be made unless a U.S. trustee has the right to withhold the estate tax imposed on the distribution.

Proposal. Under the proposal, a QDT created prior to the enactment of the 1990 OBRA whose governing instrument requires that all trustees be U.S. citizens or domestic corporations would be treated as satisfying the withholding requirement of current law.

Administration position. The Administration supports this provision of the bill. The trustee requirements for a qualified domestic trust have been amended twice in an attempt to give taxpayers greater flexibility in the choice of trustees while also protecting the government's ability to collect the tax imposed on the trust. We believe that the government's interest is adequately protected if the trust instrument requires that all trustees must be U.S. citizens or domestic corporations. The bill will reduce the number of individuals who will have to redraft wills to comply with the changes that have been made to the trustee requirement for QDTs.

5. Election of Special Use Valuation of Farm Property for Estate Tax Purposes (Section 505)

Current law. Under certain circumstances, a decedent's estate may elect to value real property used in a farm or a trade or business according to its actual use rather than its highest and best use. The election requires, among other things, the filing of an agreement signed by all the qualified heirs consenting to a recapture tax if the special use terminates within 10 years of the decedent's death. An executor who makes the election and substantially complies with the requirements in the regulation for making the election may provide missing information and certain signatures missing from the agreement within 90 days of notification by the IRS.

Proposal. Under the proposal, if the executor makes the special use valuation election and files the agreement regarding the recapture tax, the executor would be permitted to provide any missing information and signatures within 90 days of notification by IRS. This relief would be available without regard to whether the executor substantially complied with the regulatory requirements for making the election.

Administration position. The Administration does not oppose this provision. The special use valuation election is frequently defective because the executor fails to file certain required information or signatures. By expanding the scope of the provision that permits defective elections to be cured, the bill simplifies qualification for the special use valuation in those estates for which it was intended to be available.

TITLE VI. EXCISE TAX PROVISIONS

A. Motor Fuel Excise Tax Provisions

1. Use Tax on Diesel and Aviation Fuel (Section 601)

Current law. Section 4091 imposes a tax on the sale of diesel or aviation fuel by a producer. For this purpose, a wholesaler or a tax-free purchaser (e.g., a State government) is treated as a producer, and a nonexempt use of fuel by a producer is treated as a sale. A person that purchases fuel at a reduced tax rate (e.g., for use in a bus or train) is not treated as a producer. Thus, section 4091 does not impose a tax when a reduced-tax purchaser diverts fuel to a nonexempt use. Section 4041 imposes a back-up use tax on fuel diverted to nonexempt uses, but this tax is redundant in the case of fuel diverted by a tax-free purchaser and does not apply to fuel diverted by a reduced-tax purchaser.

Proposal. The bill would combine the diesel and aviation fuel tax provisions into a revised section 4091. Reduced-tax purchasers would be treated as producers for purposes of the tax imposed by the revised section 4091 and would be liable for the tax when they divert fuel to a nonexempt use. The bill would also reorganize section 4041.

Administration position. We support the proposal. The proposal improves the organizational structure of the diesel and aviation fuel excise tax statutes, making the rules easier to locate and understand. The imposition of tax on fuel diverted to nonexempt uses by reduced-tax producers ensures equivalent treatment of nonexempt uses of diesel and aviation fuel by tax-free and reduced-tax purchasers.

2. Refunds of Diesel and Aviation Fuel Taxes (Section 602(a))

Current law. Producers (including wholesalers) of diesel or aviation fuel can make tax-free sales to exempt purchasers (e.g., a State government). If, however, a retailer sells diesel or aviation fuel on which tax has been paid to an exempt purchaser, only the exempt purchaser can claim a refund of the tax.

Proposal. The bill would permit the person who paid the tax (generally the wholesaler) to claim the refund if the amount of the tax is repaid to the retailer. (Presumably, the wholesaler would reimburse the retailer only if the retailer sells the fuel to an exempt purchaser at a tax-free price.) This rule would apply only to fuel sold for use in one of the following exempt uses: (1) export, (2) use as supplies for aircraft or vessels, (3) exclusive use by a State or local government, or (4) exclusive use by a nonprofit educational organization. In addition, refunds would be permitted only if the person paying the tax meets such requirements as the Treasury Department may impose under the regulatory authority provided in the bill.

Administration position. We do not oppose the proposal. The proposal significantly simplifies refund procedures for diesel and aviation fuel sold to certain exempt users and conforms those procedures to those applicable to special motor fuels and gasoline. Under the proposal, however, there is a possibility of refund claims by both the wholesaler and the exempt user, and we expect it will be necessary to prescribe regulatory safeguards under the authority provided in the bill. These safeguards, including appropriate certifications by the exempt user, would be designed to prevent an exempt user from claiming a refund if the tax is refunded to the wholesaler. They would also assume that a wholesaler claiming a refund does not pass the tax on in the price of the product by requiring the wholesaler to establish that the price does not include the tax.

3. Consolidation of Refund Provisions (Section 602(b))

Current law. The excise tax imposed on fuel is refunded if the fuel is used for an exempt purpose. Refunds of fuel taxes are currently authorized under three separate Code sections.

Refunds may be claimed annually as a credit on the taxpayer's income tax return. In most cases, taxpayers also have the option of claiming quarterly refunds for the first three quarters of a taxable year. This option is not available, however, with respect to taxes imposed on gasoline and special motor fuel used on a farm for farming purposes. In addition, quarterly refunds are permitted only if the amount of the refund meets a statutory threshold. Different thresholds are prescribed depending on the Code provision authorizing the refund, and claimants may not aggregate refunds authorized under different Code sections (e.g., gasoline refunds authorized under section 6421 and diesel fuel refunds authorized under section 6427) in determining whether the statutory threshold is met.

An expedited refund procedure is available for gasohol blenders.

Proposal. The bill would consolidate the Code provisions authorizing refunds into a single section. This section would prescribe only one refund threshold, and all gasoline and diesel fuel refunds would be aggregated in determining whether this threshold is met. A refund would be permitted for any quarter (including the fourth quarter) in which the cumulative overpayment exceeds $750. Refunds would be permitted under this rule with respect to taxes imposed on gasoline and special motor fuel used on a farm for farming purposes. The special expedited procedure for gasohol blenders would be retained.

Administration position. We do not oppose the proposal. The proposal significantly simplifies the refund procedures by consolidating the rules in a single section and providing uniform threshold and refund procedures. A single standardized refund claim for all fuel taxes reduces administrative burdens imposed on taxpayers that are eligible for refunds of several different types of excise tax.

4. Refunds to Cropdusters (Section 602(b))

Current law. The excise tax imposed on gasoline or aviation fuel is refunded if the fuel is used for cropdusting. The tax is generally refunded to the farmer; the cropduster is entitled to a refund only if the farmer waives the right to a refund.

Proposal. The bill would eliminate the waiver requirement and provide that only the cropduster is entitled to the refund.

Administration position. We do not oppose the proposal. The waiver requirement is cumbersome and prevents many cropdusters from claiming refunds.

5. Information Reporting on Certain Sales (Section 603)

Current law. When diesel or aviation fuel is sold free of tax or at a reduced tax rate, both the seller and the purchaser are required to file an information return with the IRS.

Proposal. The bill would permit the Treasury Department to issue regulations waiving the information reporting requirement.

Administration position. We support the proposal. The authority to waive the reporting requirement in appropriate cases will allow the IRS to administer the exemptions more efficiently and relieve taxpayers of unnecessary paperwork burdens.

B. Alcohol Excise Tax Provisions

Imported Distilled Spirits Returned to Plant (Section 611)

Current law. When tax-paid distilled spirits that have been withdrawn from bonded premises of a distilled spirits plant are returned for destruction or redistilling, the excise taxes are refunded or credited. Bottled imported distilled spirits are not eligible for this refund or credit because they are originally withdrawn from customs custody and not bonded premises. Additionally, distilled spirits brought into the United States from Puerto Rico are not eligible because they are not withdrawn from bonded premises.

Proposal. The bill would provide that refunds or credits of the tax would be available for all spirits that are returned to the bonded premises of a distilled spirits plant.

Cancellation of Export Bonds (Section 612)

Current law. An exporter that withdraws distilled spirits from bonded warehouses for export or transportation to a customs bonded warehouse without the payment of tax must furnish a bond to cover the withdrawal. The required bonds are canceled "on the submission of such evidence, records, and certification indicating exportation as the Secretary may by regulations prescribe."

Proposal. The bill would allow the bonds to be canceled "if there is such proof of exportation as the Secretary may require." Under this rule, the Treasury Department could permit exporters to satisfy the proof requirement by maintaining records of exportation. Thus, bonds could be canceled without submission of proof of exportation.

Location of Records of Distilled Spirits Plant (Section 613)

Current law. Proprietors of distilled spirits plants are required to maintain records and reports relating to their production, storage, denaturation, and processing activities on the premises where the operations covered by the records are carried on.

Proposal. The bill would permit proprietors to maintain records and reports at locations other than the plant premises. As under current law, the records and reports would be required to be available for inspection by the Treasury Department during business hours.

Transfers from Brewery to Distilled Spirits Plant (Section 614)

Current law. A distilled spirits plant may receive tax-free beer on its bonded premises for use in the production of distilled spirits. This rule applies only if the beer is produced on contiguous brewery premises.

Proposal. The bill would provide an exemption from excise tax, subject to Treasury regulations, for beer removed to a distilled spirits plant from any brewery for use in the production of distilled spirits. The bill would also authorize the receipt of such beer by a distilled spirits plant.

Sign Not Required for Wholesale Dealers (Section 615)

Current law. Wholesale liquor dealers are required to post a sign identifying the firm as such. Failure to do so is subject to a penalty.

Proposal. The bill would repeal the requirement that a sign be posted.

Refund on Returns of Merchantable Wine (Section 616)

Current law. Excise tax paid on domestic wine that is returned to bond as unmerchantable is refunded or credited, and the wine is once again treated as wine in bond on the premises of a bonded wine cellar.

Proposal. The bill would permit a refund or credit in the case of all domestic wine returned to bond, whether or not unmerchantable.

Increased Sugar Limits for Certain Wine (Section 617)

Current law. Natural wines may be sweetened to correct high acid content. If the amount of sugar used exceeds the applicable limitation, however, the wine must be labeled "Substandard." For most wines the limitation is exceeded if sugar constitutes more than 35 percent (by volume) of the combined sugar and juice used to produce the wine. Up to 60 percent sugar may be used in wine made from loganberries, currants, and gooseberries.

Proposal. The bill would provide that up to 60 percent sugar could be used in any wine made from juice, such as cranberry or plum juice, with an acid content of 20 or more parts per thousand.

Beer Withdrawn for Embassy Use (Section 618)

Current law. Imported beer, wine, and distilled spirits to be used for the family and official use of foreign governments, organizations and individuals may be withdrawn from customs bonded warehouses without payment of excise tax. A similar rule applies to domestically produced wine and distilled spirits. There is no similar exemption for domestic beer withdrawn from a brewery or entered into a bonded customs warehouse for the same authorized use.

Proposal. The bill would provide an exemption for domestic beer similar to that available for domestically produced wine and spirits. The exemption would be subject to Treasury's regulatory authority.

Beer Withdrawn for Destruction (Section 619)

Current law. Beer removed from a brewery for destruction must be tax-paid rather than withdrawn without payment of excise tax.

Proposal. The bill would provide an exemption from tax for removals for destruction, subject to Treasury regulations.

Drawback on Exported Beer (Section 620)

Current law. A domestic producer that exports beer may recover the tax (receive a "drawback") found to have been paid on the exported beer upon the "submission of such evidence, records and certificates indicating exportation" required by regulations.

Proposal. The bill would allow a drawback of tax paid "if there is such proof of exportation as the Secretary may by regulations require." Under this rule, the Treasury Department could permit exporters to satisfy the proof requirement by maintaining records of exportation. Thus, tax could be refunded without submission of proof of exportation.

Imported Beer Transferred in Bulk to Brewery (Section 621)

Current law. Imported bulk and bottled beer is subject to tax when removed from customs custody.

Proposal. The bill would provide that, subject to Treasury regulations, beer imported in bulk containers could be withdrawn from customs custody and transferred in bulk to a brewery without payment of tax. Under this provision, the proprietor of the brewery to which the beer is transferred is liable for the tax imposed on the withdrawal from customs custody and the importer would be relieved of liability.

Administration Position on Alcohol Excise Tax Provisions. We support these proposals.

Until 1980, the method of collecting alcohol excise taxes required the regular presence of Treasury Department inspectors at alcohol production facilities. In 1980, the method of collecting tax was changed to a bonded premises system under which examinations and collection procedures are similar to those used in connection with other Federal taxes.

A number of proposals conform reporting and recordkeeping requirements to the current collection system. These changes will allow the Bureau of Alcohol, Tobacco, and Firearms to administer alcohol excise taxes more efficiently and relieve taxpayers of unnecessary paperwork burdens.

Other proposals expand the circumstances in which the Code permits tax-free removals of alcoholic beverages (or allows a credit or refund of tax on a return to bonded premises). These changes are also consistent with the current collection system and will not jeopardize the collection of tax revenues. In a number of cases, the changes will eliminate inappropriate disparities in the treatment of different types of alcoholic beverages. In addition, several of these proposals will provide producers with additional options in complying with environmental and other laws that regulate the destruction and disposition of these products.

The remaining proposals (i.e., the repeal of the sign requirement and the increased sugar limits for certain wine) repeal or revise outmoded provisions. We do not believe the adoption of these proposals will have adverse consequences.

C. Other Excise Tax Provisions

1. Waiver of Registration Requirement (Section 631)

Current law. The Code exempts certain types of sales (e.g., sales for use in further manufacture, sales for export, and sales for exclusive use by a State or local government or a nonprofit educational organization) from excise taxes imposed on manufacturers and retailers. These exemptions generally apply only if the seller, the purchaser, and any person to whom the article is resold by the purchaser (the second purchaser) are registered with the IRS. The IRS can waive the registration requirement for the purchaser and second purchaser in some but not all cases.

Proposal. The bill would authorize the Treasury Department to specify the cases in which the registration requirement applies to purchasers and second purchasers. Exempt sales to unregistered purchasers and second purchasers would be permitted in all other cases.

Administration position. We support the proposal. The authority to waive the registration requirement in appropriate cases will allow the IRS to administer the exemptions more efficiently and relieve taxpayers of unnecessary paperwork burdens.

2. Deadwood--Piggyback Trailers and Deep Seabed Minerals (Section 632)

Current law. The Code includes a provision relating to a temporary reduction in the tax on piggyback trailers sold before July 18, 1985, and provisions relating to the tax on the removal of hard minerals from the deep seabed before June 28, 1990.

Proposal. The bill would repeal these provisions.

Administration position. We support the proposal. Continued retention of these deadwood provisions is unnecessary.

TITLE VII. ADMINISTRATIVE PROVISIONS

A. Administrative Provisions

1. Employment Tax Reporting for Household Employees (Section 701)

Current law. Household employers who pay cash wages of $50 or more per quarter must withhold social security taxes (including Medicare taxes) from wages paid to the employee during the quarter. The withheld taxes, together with the portion of the tax paid by the employer, are paid with a quarterly FICA return on Form 942. Household employers who pay cash wages of $1,000 or more in any calendar quarter in the current year or the preceding year are subject to Federal unemployment taxes and must file an annual FUTA return on Form 940 or Form 940EZ. Quarterly deposits are required if certain FUTA liability thresholds are met. Although wages of household employees are not subject to mandatory income tax withholding, an employer and employee may enter into a voluntary withholding agreement. In that case, withheld income taxes are reported and paid on the quarterly return filed for FICA purposes. After the end of each calendar year, household employers must provide copies of Form W-2 (Wage and Tax Statement) to each employee and must transmit all Forms W-2 to the Social Security Administration with Form W-3 (Transmittal of Income and Tax Statements).

Household employers subject to FUTA are typically required to file quarterly state unemployment tax returns as well.

Proposal. Household employers would report all FICA and FUTA taxes and any withheld income taxes ("domestic service employment taxes") on a schedule to Form 1040. No quarterly payments or deposits would be required, but domestic service employment taxes would be counted in determining the employer's estimated tax penalty. Thus, a household employer would be required either to make payments of estimated taxes or to increase the rate of withholding on his own wages to cover his liability for domestic service employment taxes.

To make simplified annual reporting possible, the quarterly FICA threshold would be changed to an annual threshold of $300.

In addition, the Secretary would be granted the authority to enter into agreements with the states which would allow the IRS, acting as agent for the states, to collect state unemployment taxes in the same manner.

Administration position. The Administration supports the proposal. The proposal should provide substantial simplification and increased compliance.

Current law requires employers of household employees to file 5 Federal returns annually in addition to forms such as W-3 and W-2. State unemployment reports must be separately filed on a quarterly basis, often to remit quite small liabilities ($7-8 annually). Household employers are frequently unaware of and do not comply with such requirements. By incorporating Federal return requirements into Form 1040, the compliance burden should be eased and household employers will be reminded of their filing responsibilities. While State participation in the Form 1040 filing system would be voluntary, many states may find the system cost effective to collect the relatively small sums involved.

We recommend that the proposal be made effective for remuneration paid after December 31, 1992, in order to allow the IRS to prepare forms and inform taxpayers about the new filing system. In addition, we recommend that the return due date provision be clarified to make certain that the schedule is not due earlier than the date of the Form 1040 if the taxpayer utilizes an extension to file.

2. <u>Uniform Penalty Provisions to Apply to Certain Pension Reporting Requirements</u> (Section 702)

<u>Current law</u>. Any person who fails to file an information report with the IRS on or before the prescribed filing date is subject to penalties for each failure. The general penalty structure provides that the amount of the penalty is to vary with the length of time within which the taxpayer corrects the failure, and allows taxpayers to correct a de minimis number of errors and avoid penalties entirely. A different, flat-amount penalty applies for each failure to provide information reports to the IRS or statements to payees relating to pension payments.

<u>Proposal</u>. The bill would incorporate into the general penalty structure the penalties for failure to provide information reports relating to pension payments.

<u>Administration position</u>. We support this proposal because conforming the information-reporting penalties that apply with respect to pension payments to the general information-reporting penalty structure will simplify the overall penalty structure through uniformity and provide more appropriate information-reporting penalties with respect to pension payments.

3. <u>Use of Reproductions of Returns Stored in Digital Image Format</u> (Section 703)

<u>Current law</u>. Under section 6103(p)(2), the IRS is required to provide a reproduction of a return upon request from a person entitled to disclosure of the return, and may provide return information to such a person through a variety of media. Reproductions so provided have the same legal status as the original return and may be admitted into evidence in judicial or administrative proceedings.

<u>Proposal</u>. The Code would be amended to clarify that the IRS may discharge its obligations to persons seeking disclosure of returns by furnishing them with reproductions produced through digital image technology. Such technology will eventually enable the IRS to store returns in digital image form and realize significant costs savings. The cost of storing, retrieving and copying tax returns is today about $42 million annually. The bill also would require the Comptroller General to conduct a study of available digital image technology for the purpose of determining the extent to which reproductions of documents stored using that technology accurately reflect the data on the original document and the appropriate period for retaining the original document.

<u>Administration position</u>. We support this proposal. In addition to cost savings, the use of digital image technology

will speed the retrieval of return information for use by the IRS in resolving taxpayer inquiries, conducting examinations and litigating tax issues. To ensure that accurate and legible document images are created, the IRS will institute strict quality control standards. As provided in section 6103 generally, taxpayer information will continue to be protected from unauthorized disclosure.

4. Repeal of Tax Shelter Registration Rules (Section 704)

Current law. The Code requires the registration of tax shelters with the IRS and imposes penalties for failure to comply with the registration requirements. The provisions were adopted in 1984 to enable the IRS to identify and audit more effectively tax shelter investments that had proliferated during the early 1980s. Due to changes in the tax laws since 1984, tax shelter activities have declined substantially. On the other hand, partnerships with over 500 investors have almost doubled. The tax shelter registration provisions are particularly cumbersome for such widely held partnerships. Organizers and sellers of potentially abusive tax shelters are required to keep lists of investors and to make them available to the IRS on request.

Proposal. The tax shelter registration rules would be repealed. Current law rules applicable to organizers and sellers of potentially abusive tax shelters would be retained.

Administration position. The Administration supports this provision. The steep decline in the number of tax shelters being marketed has greatly reduced the amount of information being provided under the tax shelter registration rules. The information is no longer sufficiently useful to justify the paperwork burdens it creates both for taxpayers (particularly widely held partnerships) and the IRS.

5. Repeal Authority to Disclose Whether Prospective Juror Has Been Audited (Section 705)

Current law. Section 6103(h)(5) provides that in connection with any civil or criminal tax case the Secretary (or his delegate) must disclose, upon written request from either party to the lawsuit, whether an individual who is a prospective juror has or has not been subject to any audit or other tax investigation by the IRS. In United States v. Hashimoto, 878 F. 2d 1126 (9th Cir. 1989), it was held that the defendant had an absolute right to information about prospective jurors under section 6103(h)(5), and that trial court rulings that had the effect of denying the defendant this right constituted reversible error. Following the Hashimoto decision, the IRS has received from defendants an escalating number of requests for information under section 6103(h)(5).

Proposal. The bill would repeal the authority to disclose whether prospective jurors have been audited.

Administration position. We support the repeal of section 6103(h)(5). Information regarding prior tax investigations can be elicited from prospective jurors in voir dire questioning, without resort to the cumbersome, time consuming and sometimes harmful mechanism of section 6103(h)(5) as interpreted in Hashimoto.

6. Repeal TEFRA Audit Rules For S Corporations (Section 706)

Current law. An S corporation generally is not subject to income tax on its taxable income. Instead, it files an information return and the shareholders report their pro rata share of the S corporation's income and deductions on the shareholders' tax return. The Subchapter S Revision Act of 1982 generally made the TEFRA partnership audit and litigation rules applicable to S corporations. These rules require the determination of all "Subchapter S items" at the corporate, rather than the shareholder, level. These rules also require a shareholder to report all Subchapter S items consistently with the corporation's information return or to notify the IRS of any inconsistency.

Proposal. The bill would repeal the unified audit procedures for S corporations, but retain the requirement that shareholders report items in a manner consistent with the corporation's return.

Administration position. We support repeal of the TEFRA audit rules for S corporations. The vast majority of both existing and newly formed S corporations are expected to qualify for the small S corporation exception from the unified audit and litigation provisions. Accordingly, a unified audit procedure, with the intendant necessity for the IRS and the courts to prescribe special rules and procedures, is unnecessary and often confusing for those S corporations subject to the provision.

It would be desirable before final enactment to clarify the effect of the provision on pending proceedings and years before the effective date as to which no proceeding is pending. The provision also should be effective for taxable years ending after a given date, rather than for taxable years starting after a given date. The precise date an S corporation's first taxable year commences may be unclear in certain cases.

7. Limitations on Assessment and Collection (Section 707)

Current law. Taxpayers who have invested or that have an interest in passthrough entities such as partnerships, S corporations and trusts currently are asserting that the IRS cannot make adjustments to their returns with open statutes of limitations when the adjustments asserted arise from distributions from passthrough entities for which the statutes of limitations have expired. Recent court cases have given support to taxpayers. See Kelley v. Commissioner, 977 F.2d 756 (9th Cir. 1989), in which the Ninth Circuit held that an extension of time for assessing tax for the 1980 year executed by a shareholder of an S corporation did not permit an S corporation adjustment to the shareholder's return if the statute of limitations with respect to the S corporation had expired, and Fendell v. Commissioner, 906 F.2d 362 (8th Cir. 1990), in which the Eighth Circuit held that the Commissioner cannot adjust individual income tax returns for 1975 and 1977 with open statutes of limitations, when the adjustments arise from the distributions to a beneficiary of income from a complex trust for which the statute of limitations has expired.

Proposal. The proposal would clarify that the running of the statute of limitations begins with the filing of the return of the taxpayer whose liability is in question, rather than the filing of the return of another person (such as a partnership, S corporation, or trust) from which the taxpayer received some item of income, gain, loss, deduction, or credit. The proposal would not affect the statute of limitations applicable to an entity subject to the TEFRA unified audit rules.

Administration position. We support this clarification, because it would avoid years of protracted and costly litigation over collateral matters.

B. Tax Court Provisions

1. Overpayment Determinations of the Tax Court (Section 711)

Current law. The Tax Court has jurisdiction to order the refund of an overpayment determined by the Court, plus interest, if the IRS fails to refund such overpayment and interest within 120 days after the Court's decision becomes final. Whether such an order is appealable is uncertain. In addition, whether the Tax Court has jurisdiction over the validity or merits of certain credits or offsets (e.g., student loans, child support, etc.) made by the IRS which serve to reduce or eliminate the refund to which the taxpayer was otherwise entitled is unclear.

Proposal. The bill would clarify that these orders are appealable in the same manner as a decision of the Tax Court. The bill would also clarify that the Tax Court does not have any jurisdiction over the validity or merits of any credit or offset made by the IRS which would serve to reduce or eliminate the refund to which the taxpayer was otherwise entitled.

Administration position. We support the bill's clarification of current law.

2. Awarding of Administrative Costs (Section 712)

Current law. Any person who substantially prevails in any action brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty may be awarded reasonable administrative costs incurred before the IRS and reasonable litigation costs incurred in connection with any court proceeding. No time limit is specified for the taxpayer to apply to the IRS for an award of administrative costs. In addition, no time limit is specified for a taxpayer to appeal to the Tax Court an IRS decision denying an award of administrative costs. Finally, the procedural rules for adjudicating denial of administrative costs are unclear.

Proposal. The bill would provide that a party who seeks an award of administrative costs must apply for such costs within 90 days of the date on which the party was determined to be a prevailing party. The bill would also provide that a party who seeks to appeal a denial by the IRS of an administrative costs award must petition the Tax Court within 90 days after the date that the IRS mails the denial notice. The bill would clarify that dispositions of administrative cost petitions by the Tax Court are reviewed in the same manner as other decisions of the Tax Court.

Administration position. We support clarifying the procedures for applying for a cost award and appealing from a denial of such an award.

3. Redetermination of Interest Pursuant to Motion (Section 713)

Current law. Section 7481(c)(4) provides that a taxpayer may seek a redetermination of interest after certain decisions of the Tax Court by filing a petition with the Tax Court.

Proposal. The bill would substitute a motion for a petition for this purpose.

Administration position. We support this clarification because it serves both to eliminate possible confusion and conforms the terminology of section 7481(c)(4) to that of analogous sections, such as section 6512(b)(2), which directs the taxpayer to invoke the Tax Court's jurisdiction in other types of supplementary proceedings by motion.

4. Application of Net Worth Requirement for Awards of Litigation Costs (Section 714)

Current law. In the Federal courts, including the Tax Court and the Claims Court, a taxpayer who prevails may be awarded reasonable litigation costs, including attorneys' fees. The Code provides that the prevailing party must meet the net worth requirements of section 2412(d)(2)(B) of title 28, United States Code. The provision is silent as to whether the net worth requirement relates to trusts and estates.

Proposal. The bill would clarify that the net worth requirement applies to trusts (determined as of the last day of the taxable year involved in the proceeding) and estates (determined as of the date of the decedent's death). The bill also would provide that individuals who file a joint tax return are treated as one individual for purposes of computing the net worth limitations. An exception to this rule would be provided for innocent spouses.

Administration position. We support clarifying that the net worth requirement applies to trusts and estates and that individuals filing a joint return are treated as one individual for purposes of the net worth requirement.

C. Cooperative Agreements

Permit IRS to Enter Into Cooperative Agreements With State Tax Authorities (Section 721)

Current law. The IRS is generally not authorized to use funds appropriated for Federal tax administration to provide services to non-Federal agencies even if the cost is reimbursed.

Proposal. The IRS would be authorized to enter into reimbursable agreements with the states to enhance joint tax administration. Reimbursable costs would include such items as data processing, software development and hardware acquisition as well as personnel costs, travel, and visual items involved in providing a service.

Administration position. We support authorizing the IRS to enter into reimbursable agreements with the states for these purposes. The proposal could lead to joint Federal-state programs which would simplify and shorten return preparation time for taxpayers and reduce processing costs at both the Federal and state level.

CORRECTED (if checked)

PARTNERSHIP'S name, street address, city, state, and ZIP code		1 Taxable income (loss) from passive activities $	OMB No. 1545-XXXX 1992	Partner's Share of Income (Loss) From a Large Partnership
		2 Taxable income (loss) from other activities $		
PARTNERSHIP'S Employer I.D. number	PARTNER'S identifying number	3 Net capital gain from passive activities $	4 Net capital gain from other activities $	Copy B For Partner This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
PARTNER'S name		5 Net passive AMT adjustment $	6 Net other AMT adjustment $	
Street address (including apt. no.)		7 Other		
City, state, and ZIP code				

Form 1099K

Department of the Treasury - Internal Revenue Service

DRAFT

Instructions to Individual Partners Filing Form 1040

(Filers of Other Returns: Follow the instructions for your tax return instead of the instructions shown below.)

Box 1.--If income is reported in box 1, report the income on **Schedule E**, Part II, column (h). If a loss is reported in box 1, report the loss following the Form 8582 instructions, to determine how much of the loss can be reported on **Schedule E**, Part II, column (g). See the **Schedule E** instructions for other rules that limit losses.

Box 2.--Report the income or loss in box 2 on **Schedule E**, Part II, column (i) or (k). See the **Schedule E** instructions for special rules that limit losses.

Box 3.--Report the gain in box 3 on **Schedule D**, line 11, column (g).

Box 4.--Report the gain in box 4 on **Schedule D**, line 11, column (g).

Box 5.--If you are required to file **Form 6251**, Alternative Minimum Tax--Individuals, include this amount on **Form 6251**, line 4s.

Box 6.--If you are required to file **Form 6251**, include this amount on **Form 6251**, line 4q.

Box 7.--Follow the instructions shown below for the code(s) shown in this box:

Code A--General credits.--Report this amount on **Form 3800**, line 7.

Code B--Low-income housing credit for property placed in service after 1989.--Report this amount on **Form 8586**, line 5.

Code C--Rehabilitation credit (including low-income housing credit for property placed in service before 1990).--Report this amount on **Form 3468**, line 3c.

Code D1 through D6--Foreign tax credit information:

Code D1--Type of income.--Check the box for this category of income on **Form 1116**.
Code D2-- Name of foreign country.--Enter on **Form 1116**, **Part I**, column A, B, or C.
Code D3--Total gross income from sources outside the U.S..--Enter this amount on **Form 1116**, line 1. Enter "partnership income" on the dotted line to the left of the entry space for line 1.
Code D4--Total applicable deductions and losses.--Enter this amount on **Form 1116**, line 2.
Code D5--Total foreign taxes paid or accrued.--Enter this amount on **Form 1116**, line 8.
Code D6--Reduction in taxes available for the credit.--Enter this amount on **Form 1116**, line 12.

Code E--Tax-exempt interest.--Report this amount on **Form 1040**, line 8b.

TREASURY NEWS

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

LIBRARY, ROOM 5310
SEP 25 1991 11309
DEPT. OF THE TREASURY

FOR RELEASE AT 2:30 P.M.
September 10, 1991

CONTACT: Office of Financing
202/219-3350

TREASURY'S WEEKLY BILL OFFERING

The Department of the Treasury, by this public notice, invites tenders for two series of Treasury bills totaling approximately $21,200 million, to be issued September 19, 1991. This offering will result in a paydown for the Treasury of about $2,325 million, as the maturing bills total $23,522 million (including the 16-day cash management bills issued September 3, 1991, in the amount of $5,015 million). Tenders will be received at Federal Reserve Banks and Branches and at the Bureau of the Public Debt, Washington, D. C. 20239-1500, Monday, September 16, 1991, prior to 12:00 noon for noncompetitive tenders and prior to 1:00 p.m., Eastern Daylight Saving time, for competitive tenders. The two series offered are as follows:

91-day bills (to maturity date) for approximately $10,600 million, representing an additional amount of bills dated December 20, 1990, and to mature December 19, 1991 (CUSIP No. 912794 WX 8), currently outstanding in the amount of $21,840 million, the additional and original bills to be freely interchangeable.

182-day bills for approximately $10,600 million, to be dated September 19, 1991, and to mature March 19, 1992 (CUSIP No. 912794 YE 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 September 19, 1991. 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 $2,406 million as agents for foreign and international monetary authorities, and $4,290 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 5176-1 (for 13-week series) or Form PD 5176-2 (for 26-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 one-half hour prior to the closing time for receipt of tenders 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 competitive 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.

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.

If a bill is purchased at issue, and is held to maturity, the amount of discount is reportable as ordinary income on the Federal income tax return of the owner for the year in which the bill matures. 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, any gain in excess of the basis is treated as ordinary income.

Department of the Treasury Circulars, Public Debt Series - Nos. 26-76, 27-76, and 2-86, as applicable, 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.

8/89