EXPIRING TAX PROVISIONS

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

MAY 9, 1995

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CONTENTS

SUBMISSIONS FOR THE RECORD

EXPIRING TAX PROVISIONS

TUESDAY, MAY 9, 1995

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:15 a.m., in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson (Chairman of the Subcommittee) presiding.

[The advisory announcing the hearing follows:]

ADVISORY 26-186

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
April 19, 1995
No. OV-6

CONTACT: (202) 225-1721

JOHNSON ANNOUNCES HEARING ON THE TARGETED JOBS TAX CREDIT, THE EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE, THE ORPHAN DRUG CREDIT AND OTHER TEMPORARY TAX PROVISIONS

Congresswoman Nancy L. Johnson (R-CT), Chairman, Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing to examine issues relating to several recently expired provisions of the tax laws, including the targeted jobs tax credit (TJTC), the exclusion for employer-provided educational assistance, the tax credit for orphan drug clinical testing expenses, and the special rule for certain contributions of qualified appreciated stock to private foundations, as well as other tax provisions scheduled to expire. **The hearing will take place on Tuesday, May 9, 1995, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

BACKGROUND:

Targeted Jobs Tax Credit. Prior to January 1, 1995, certain employers could claim a credit based on qualifying wages paid to individuals from several targeted groups (Code section 51). The targeted groups consisted of individuals who generally were recipients of payments under means-tested transfer programs, economically disadvantaged, or disabled. The credit was equal to 40 percent of up to $6,000 of first-year wages paid to a certified member of a targeted group. Thus, the maximum credit generally was $2,400 per individual. With respect to economically disadvantaged summer youth employees, the credit was equal to 40 percent of up to $3,000 of wages, for a maximum credit of $1,200. The credit expired for individuals who began work for an employer after December 31, 1994.

Exclusion for Employer-Provided Educational Assistance. Prior to January 1, 1995, an employee's gross income and wages for income and employment tax purposes did not include amounts paid or incurred by the employer for educational assistance provided to the employee if such amounts were paid or incurred pursuant to an educational assistance program that met certain requirements (Code section 127). This exclusion, which expired with respect to amounts paid after December 31, 1994, was limited to $5,250 of educational assistance with respect to an individual during a calendar year. In the absence of the exclusion, for purposes of income and employment taxes, an employee generally is required to include in income and wages the value of educational assistance provided by the employer unless the cost of such assistance qualifies as a deductible job-related expense of the employee.

Tax Credit for Orphan Drug Clinical Testing Expenses. The orphan drug credit (Code section 28) provided a 50-percent nonrefundable tax credit for a taxpayer's qualified clinical testing expenses paid or incurred in the testing of certain drugs for rare diseases, generally referred to as "orphan drugs." Qualified testing expenses are costs incurred to test an orphan drug after the drug has been approved for human testing by the Food and Drug Administration (FDA) but before the drug has been approved for sale by the FDA. The orphan drug credit expired after December 31, 1994.

Gifts of Publicly-Traded Stock to Private Foundations. Prior to January 1, 1995, the deduction allowable for charitable contributions to private nonoperating foundations of certain readily marketable stock was the full fair market value of the stock on the date of contribution (Code section 170 (e)(5)). Thus, for donations made during the period prior law was applicable (July 19, 1984, through December 31, 1994), the rule generally applicable to donations of capital-gain property to nonoperating foundations (sec. 170(e)(1)(B)(ii)) -- which generally limits the deductible amount to the asset's cost -- did not apply to contributions of such stock.

Federal Unemployment Tax Act (FUTA) Exemption for H-2A Agricultural Workers. Under a program administered by the Immigration and Naturalization Service, aliens are admitted to the U.S. on a temporary basis to perform agricultural labor. Prior to January 1, 1995, this agricultural labor was exempt for purposes of FUTA employment taxes (Code section 3306(c)(l)).

-MORE-

Production Tax Credit for Nonconventional Fuels. Under current law, certain nonconventional fuels are eligible for a production credit equal to $3 per barrel or Btu oil barrel equivalent (Code section 29). The Energy Policy Act of 1992 extended the credit, for gas produced from biomass or synthetic coal fuels. These fuels must be produced domestically from a facility placed in service before January 1, 1997, pursuant to a written binding contract in effect before January 1, 1996. Fuels produced from facilities which satisfy the binding contract rule may qualify for the credit if sold before January 1, 2008.

Transportation Fuels Tax Exemption for Aviation Jet Fuel. The Omnibus Budget Reconciliation Act of 1993 generally imposed a 4.3 cents per gallon excise tax on transportation fuels effective October 1, 1993. However, a two-year delay from the transportation tax was provided for gasoline and jet fuels used in commercial aviation. Thus, on October 1, 1995, the current commercial aviation fuels tax exemption will expire. Revenues generated by the transportation excise tax are retained in the General Fund of the Treasury.

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearing must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business, Wednesday, April 26, 1995. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Oversight will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff at (202) 225-7601.

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline. Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies of their prepared statements for review by Members prior to the hearing. **Testimony should arrive at the Subcommittee on Oversight office, room 1136 Longworth House Office Building, no later than 5:00 p.m. on Friday, May 5, 1995.** Failure to do so may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business, Tuesday, May 23, 1995, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

FORMATTING REQUIREMENTS:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are now available over the Internet at 'GOPHER.HOUSE.GOV' under 'HOUSE COMMITTEE INFORMATION'.

Chairman JOHNSON. Good morning.

We have a long day ahead of us, so I am going to be brief, and I will encourage my colleagues and the witnesses to be sensitive to the difficulty of examining seven provisions of tax policy in a single day and to observe the limitations of our time.

Perhaps someone should call the National Enquirer, because when I first looked over the list of expiring provisions we are considering today, I could have sworn I saw Elvis. [Laughter.]

Just to give you some idea of how long we have been temporarily extending some of these provisions, in 1978 the Shah was in power in Iran, Brezhnev was in power in the Soviet Union, a letter could be mailed for 15 cents, "Annie Hall" won an Oscar, and the best-selling album of the year was "Saturday Night Fever." Disco may be gone, but the expiring provisions, like Elvis, live on.

All of these provisions have some merit. In fact, I have sponsored or cosponsored legislation to extend many of them. However, it is not clear that we can afford to extend them all. It is indeed timely and appropriate to examine these provisions to see how well they are working, to determine which of them may need fine-tuning, and to decide whether some of them have outlived their usefulness.

It is my hope that the 104th Congress will determine which of these provisions have sufficient merit to justify enacting them permanently and which we can do without. We do not have a limitless list of loophole closers. Every time we extend expiring provisions, we have to make up the revenue somewhere else.

If we were to make permanent each of the seven provisions we are examining today, along with the two provisions we will be considering tomorrow, the R&E credit and the research expense allocation rule, the 5-year cost to the Treasury would be nearly $20 billion. Of course, budget policy may dictate resorting to temporary extensions, something which provides less certainty and a greater administrative burden for taxpayers and the service alike. In any event, with the budget deficit as a backdrop, we do not have the luxury of ignoring the costs associated with extending these provisions.

I welcome today our witnesses and I thank them for joining us.

With that, I will yield to my Ranking Member, Mr. Matsui.

Mr. MATSUI. I would like to thank Chairwoman Johnson for putting on these hearings. I think they are extremely important, particularly in light of the fact that this year we would like to make certain provisions permanent, and I would like to associate myself with her remarks in terms of the issue of permanency.

Let me just make a couple of very brief observations about the extension of these provisions. I would hope, as Chairwoman Johnson has indicated, that we do make these provisions permanent, for two reasons: One, obviously, we do not get a chance to really prioritize. As these provisions come up, we reach a deadline, we have very little opportunity to either make changes or prioritize and look at others and drop some, because they all tend to go together. Of course, that is not really a good way to legislate.

The second reason is that we need to create certainty. We need to create certainty for those that use this credit. The R&E credit is a great example. Many of the business leaders, high-tech companies and others that use this credit have always assumed that they

were going to be extended, but when we reach a deadline, uncertainty occurs. They might be preparing their fiscal budget for the next 2 or 3 years, and it does create a great deal of difficulty and problems.

Certainly, the issue of financing, as the Chairwoman indicated, is always there that we have to deal with. Nevertheless, it is my hope that we will be able to make these provisions or at least some of these provisions permanent in this Congress, so that we will not have to deal with this as we have in the past.

I would like to also indicate that there are four provisions that I would like to see extended permanently. I will not mention them, but I am going to be working on these with the Chair, with the notion that we do make, for example, the research experimentation credit, the allocation of research experimentation credit, and the allocation of research experimentation expenses and a number of others permanent.

With that, if time permits, I would like to yield to Mr. Levin from Michigan.

Chairman JOHNSON. Do any other Members have an opening statement?

Mr. Levin.

Mr. LEVIN. Madam Chairwoman, I would ask that my opening statement be put in the record.

Chairman JOHNSON. Without objection.

Mr. LEVIN. Let me just briefly say a few things. I would like to move along, because our colleagues have been patient, and there are many more witnesses to come.

First of all, I would like to commend you for this hearing. It will be lengthy, but I very much agree with your insistence that we do this thoroughly.

Let me just say a word about employer provided education assistance and its importance, section 127. I think sometimes we underestimate the impact of the Code on the overall competitiveness of this country. I feel very deeply about its extension, and that is why the first day of the session, Mr. Shaw and I introduced legislation to reinstate and permanently extend it.

This provision has been a win-win provision for this country, for employers and employees alike. It has helped thousands of people to be retrained, move up the ladder of success to their benefit and the benefit of their companies.

In my statement, I refer to a gentleman by the name of Earl Hartman who worked at the GM Tech Center in Warren, Michigan, for 29 years. He had to quit school at the beginning of his employment to help raise his family. Now, he has been able to return to college and become a computer programmer.

The vast majority of people who benefit from this program, about 70 percent, earn less than $30,000 a year. Without this credit, without this exemption, they would not be able to continue. This deduction, to state the provisions technically correct, is vital for employees and employers alike. Together it provides really the tools so that they can be on the cutting edge of tomorrow's developments economically.

My colleagues, I hope very much that when we end this hearing, we will conclude that this is a vital provision and that we should permanently extend it. I would like to put in the record a statement I received today from the University of Michigan. I will leave the rest of my statement for the record.

Thank you very much.

[The opening statement follows:]

SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS

REMARKS ON EXPIRING PROVISIONS

BY

THE HONORABLE SANDER LEVIN

MAY 9, 1995

Madam Chairwoman, I would like to thank you for calling these hearings. The issue of renewing many of these provisions has continued to be a thorn in the side of everyone involved. I believe that they will put us on the road to removing this thorn, so that we can stop coming back again and again to revisit the same old issues as this process has been particularly burdensome for all of those involved.

I would like to call attention to the provision which allows an important exemption for employer-provided education assistance. On the first day of this Congress, Representative Clay Shaw and I introduced a bill that would reinstate and permanently extend this provision in order to help the millions of workers who are not being taxed on their tuition.

This provision is a win-win proposal for employers and employees alike. Companies use it to retrain workers whose jobs or skills have become obsolete. Workers use it as a way to improve their education, to move up the ladder of success, and to stay ahead of new technologies. Failing to extend it will send the wrong message to employers and employees about the importance of education.

The importance of this exemption can be best illustrated by Earl Hartman, who worked at the GM Tech Center in Warren, Michigan, for 29 years. After having to quit school to raise a family, Mr. Hartman has been able to return to college and become a computer programmer. He is even now working toward getting his Master's degree in science and technology.

Since the creation of employee educational assistance programs, millions of workers, much like Earl Hartman, have benefited by using them as a means to upgrade skills and keep up to speed with new competitive, technological, industrial developments.

Seventy percent of those who us this training earn less than $30,000 a year. Many of who have contacted me about this exemption say they will not be able to continue their education without this deduction because they simply cannot afford to pay the taxes that have been tacked onto their tuition.

The people who use this provision will be tomorrow's engineers, accountants, computer specialists, in short, tomorrow's cutting edge. This exemption is important to people who live in suburban areas, much like the one I represent. They know first-hand that staying on the cutting edge of new skills is the only way to protect themselves in our rapidly changing economy.

Since "employee educational assistance" began, millions of workers have used them to upgrade their skills and keep up to speed with new technological and industrial developments.

I hope that by the end of today's hearing the members of this Subcommittee will realize the importance of this exemption to employers, to employee's, and to the nation as a whole.

Chairman JOHNSON. Thank you, Mr. Levin.
Mr. Houghton.

STATEMENT OF HON. AMO HOUGHTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. HOUGHTON. Thank you, Madam Chairman.

Could I just make a comment. It is not easy to hear your voices. I do not know what happens to the back of the room, but maybe if they could put up the volume a little bit, it would be great.

Chairman JOHNSON. We will tell you, as we so often do, to get close to the microphone.

Mr. HOUGHTON. Maybe I will be too loud and compensate for that.

Mr. LEVIN. You are never too loud.

Mr. HOUGHTON. I would like to thank you for letting me be here. I am here on the concept of a targeted jobs tax credit. It is good to be back at my old Committee. I will try to be brief, because you have lots of witnesses and many panels.

The reason I am here, Madam Chairman, along with Mr. Rangel, is to tell you of my plans to introduce legislation within the next several weeks to reinstate, in effect, a reform of the new and different targeted jobs tax credit. This credit is the same old plan. The concept is the same old plan as the one which was started in 1978 and which ended in December of last year. The rules are entirely different.

Why are we doing this? For one simple reason, in the House, our hopes are to change the welfare program dramatically, and that means to make it essential that people, where they are able, move into the job market. The concept is good and our intentions are admirable, but there is one missing piece. Where are the jobs?

It is easy to sort of replan welfare, but to make it work, there must be receivers out there to offer work. These things just do not happen out of thin air. Somebody has to have an overwhelming need, a big heart or an incentive to take on people who usually have a very low skill base. The job market, as you know, is moving away from that type of job category.

So enter TJTC, the targeted jobs tax credit. Two million people leave welfare every year, one million because they have found jobs, but those jobs are usually temporary, and so the charade goes on. They move into a job and out of a job, into a job and out of a job.

Under the House welfare reform bill, after 5 years, we could have over 500,000 people a year going off welfare forever, and even sooner, if the States make special procedures on this. Where will these people go, into the private sector? Sure, to some degree. But let us remember that the McDonald's and the service stations and the Pizza Huts and people like that have enormous profit squeeze on them. The margin is very thin, and so many cannot take a chance.

Also, as you know, the larger corporations need sure-fire skilled and dependable people for a variety of different reasons. The private sector can and will absorb some of its own, but that will not take care of the more risky cases. Here is where the tax incentives come in. In effect, for up to a year, with varying tax incentives, you can economically justify taking a chance on someone. If you win, you have saved a life and trained a good employee and put that

person back into a self-respecting job in the work force. If you lose, you have not lost an arm and a leg in the process.

There are arguments against this, particularly the programs which expired on December 31 of last year. We have tried it and it did not work. The cost to the government was a lot of money, and over 90 percent of the people would have been employed anyway, and that is true. The concept was good and the mechanics were bad.

What have we done to fix those? We have tried to take a look at various aspects of those mechanics. For example, rather than hiring people and then shoving them into this particular category in order to get the tax incentives, there is a very careful precertification and clearing process that goes on.

Another criticism is employees do not stay on the job. You get your incentive, the employer gets the benefit and then the job is over with. We have sort of backloaded credits to give incentive to the employer to keep the employee on the job longer.

Madam Chairman, I have been around business for a good share of my life and I think this has a good chance of working. The first approach was an invitation for problems. To sum up, for welfare reform to work, there must be jobs for job seekers, and this is a good way to help the process along. It is a good investment, and in the long run it is going to save the government money.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF THE HONORABLE AMO HOUGHTON

BEFORE THE SUBCOMMITTEE ON OVERSIGHT

COMMITTEE ON WAYS AND MEANS

MAY 9, 1995

Madame Chairman, members of the Subcommittee, I am pleased to have the opportunity to appear before you to discuss a new Targeted Jobs Tax Credit program. The Targeted Jobs Tax Credit (TJTC) was enacted in 1978 to improve the private sector employment prospects of disadvantaged individuals. The credit expired on December 31, 1994 after being extended by Congress on nine occasions, most recently in the Omnibus Budget Reconciliation Act of 1993. Prior to January 1, 1995, certain employers could claim a credit based on qualifying wages paid to individuals from nine targeted employee groups. The targeted groups consisted of individuals who generally were recipients of payments under means-tested transfer programs, were economically disadvantaged, or were disabled. The credit was equal to 40 percent of up to $6,000 of first-year wages paid to a certified member of a targeted group. Thus, the maximum credit was $2,400 per individual. With respect to economically disadvantaged summer youth (aged 16 and 17, working between May 1 and September 15), the credit was equal to 40 percent of up to $3,000 of wages, for a maximum credit of $1,200.

I have developed a new program after consulting with those in the private sector who have been involved in placing and hiring individuals eligible for the program. In addition, I have reviewed the comments of those who have criticized the existing program and believe my new proposal, which is before you, addresses their concerns.

The new JOBS program targets two groups: a.) those who are receiving public assistance or b.) Youths at high risk in danger of becoming dependent on it. At the same time, the new TJTC program calls for streamlining its administration through use of objective eligibility criteria wherever possible. Precertification should eliminate any identified abuses while at the same time keeping the program user friendly.

I support the new Targeted Jobs Tax Credit program because I believe it will help to achieve a critical goal of this Congress -- providing private sector employers with the appropriate incentives to hire and train those individuals in our society who are economically disadvantaged and who are receiving or at risk of longtime dependence on public assistance programs. If we continue to have as our goal moving people away from dependence, then it is incumbent upon us to provide the private sector with the incentives they will need to hire the economically disadvantaged.

Ultimately, if we are to be a productive society, we must look to the private sector, not the public sector to provide permanent employment for our citizenry. That is why I believe that there is no better time than right now to forge a new public / private sector partnership to move people from dependency to self-sufficiency.

What convinced me to develop an improved Targeted Jobs Tax Credit program were the statistics from my own State and district. Since 1978 over 374,000 people have been hired under TJTC at a savings to New York employers of $523 million. In 1994 alone, the savings to New York employers totaled $60 million. Over the nearly 16 years of the program the State Department of Labor estimates an economic multiplier effect on the economy of New York of $10 billion.

During 1994, hiring from the categories of Medicaid, public assistance, and SSI recipients represented a federal net savings of $7.9 million. This translated into reduced spending on these programs for my State's taxpayers of $34 million.

During 1994, in my home district, there were 317 TJTC hires within the categories of welfare recipients, disabled, and ex-offenders. Taxpayers in these counties saved $1.65 million in public assistance and home relief. This amounted to a cost to the Treasury of $443,000. When reduced federal welfare, Medicaid, and SSI payments for 1994 were considered, the cost to the federal taxpayer of the TJTC program was reduced from $443,000 to $37,000.

Based upon the analysis supplied to us by New York State, in addition to what I have heard from employers across the nation, I am convinced that a TJTC program makes economic sense. We need to reinstate it as quickly as possible.

There have been valid criticisms of the program. The previous TJTC was successful, but the criticisms raised by the Department of Labor must be addressed. As a result, I have examined the concerns that have been raised. The private sector, the companies actually hiring the economically disadvantaged, incur extra costs when they choose to hire and train the structurally unemployed. That is exactly what the tax credit is designed to offset. A workable credit needs to provide a benefit to the public sector also.

As you have heard, the New York experience indicates that credit's costs are significantly offset by dramatic reductions in public assistance payments. Yet at the Federal level, because of the way we score tax incentives, we fail to take such spending savings into account. We also fail to account for the long term benefits to our society of moving people into the work force and away from dependency.

Madame Chairman, I have taken the liberty of distributing to the members of the Subcommittee a discussion draft of the new TJTC program which I intend to introduce shortly. At this point, I await a revenue estimate by the Joint Committee on Taxation and have as my goal to introduce a bill with approximately the same revenue impact as the previous TJTC program.

The first, and I believe the most significant change would be to require employers to pre-screen potential hires for TJTC eligibility prior to offering them a job. This would eliminate the so-called employer windfall issue. Probable TJTC eligibility would be known to the employer before a job was offered.

The next most significant change would encourage the transition from dependence to independence. Thus, the new TJTC program would extend the current welfare, SSI, and general assistance eligibility to include those receiving food stamps, WIC (Women, Infant, and Child), Medicaid and public housing benefits.

Higher wage and retention incentives have been incorporated. The credit would be in two tiers. Instead of the current 40% of the first $6,000 in wages earned, the new credit would be 35% of the first $5,000 earned in the first six months of employment. During the second six months of employment, the credit would be 45% of up to $5,000 in wages earned. The credit is backloaded to reward employers who are successful in keeping their TJTC workers on the job for a full year.

The high-risk youth category has been expanded to recapture 23 and 24 year olds who were dropped from the original program. Statistics indicate that those with little job history and few job skills by the time they reach ages 23 or 24 are at the greatest risk of joining the permanently unemployed and entering a life of economic dependence, or even worse, crime and drug addiction.

The veterans category has been changed to cover all veterans, not just those from the Vietnam era, who have been on public assistance during the previous 18 months. Ex-offenders, and summer youth would also be eligible for a credit. The remaining categories of eligibility from the old program have been dropped.

Most of the previous administrative difficulties and delays will be eliminated through the use of objective eligibility criteria, and the use of uniform, nationwide application forms.

I hope the Subcommittee will agree that we need to provide the private sector with the incentives it needs to seek out and hire the traditionally "hard to employ". I believe the improved TJTC program can go a long way toward fulfilling that policy goal. I look forward to receiving the Subcommittee's input and working with you on this important issue.

Chairman JOHNSON. Thank you, Mr. Houghton.
Mr. Collins.

STATEMENT OF HON. MAC COLLINS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA

Mr. COLLINS. Thank you, Madam Chairman.

I thought it was just me down here getting old and could not hear well, but I am glad to see that Amo says also he has a problem with the acoustics in this room from this perspective.

We appreciate the opportunity to discuss with you and other Members of the Committee today H.R. 752, which is to repeal a tax that has actually not been levied yet, but will come up later this year dealing with aviation fuel.

As a bit of information, Madam Chairman, we have at this point over 60 cosponsors of this piece of legislation, that is Ms. Dunn and I who actually introduced the bill, 19 Members of the Ways and Means Committee I am pleased to announce are cosponsors. For those of you who are not, we hope by the end of the day that your names can be added to the list.

Madam Chairman, it is a well known fact that the airline industry has suffered tremendously in the last few years and their financial situation is not good overall. A strong airline industry is very important to this Nation. It provides not only a number of jobs in the service area that they render, but also in many other areas that are affiliated with the airline industry as far as manufacturing or even offsite jobs around the many hubs that we have in this country.

The airline industry itself—and I have talked to a number of the chief executive officer's—actually supported the idea of deregulation several years ago, and I commend them for the way they have actually adjusted to deregulation. It has caused some tremendous difficulties for them, but they have adjusted well. Shortly after the deregulation, they had a serious downturn in the economy. We as the Federal Government, unfortunately, have compounded the problems of our Nation's airline industry with heavy-handed fees and taxes, placing the industry again in extreme financial jeopardy. This is what we hope to address and help them with in this particular provision.

I want to make a few major points and I would like to respond to any questions from the Subcommittee. First of all, beginning in October of this year, the airline industry will be required to pay a new 4.3-cents-per-gallon tax on jet fuel under the terms of the Omnibus Budget Reconciliation Act of 1993.

The tax is projected to cost the airlines more than $527 million annually, and that is already on top of $6.5 billion in annual fees and taxes industry has already collected, which again is on top of any local, State, and Federal taxes which businesses already pay.

The point I hope everyone will keep in mind is that the industry is not trying to escape paying its fair share of the country's tax burden, because the industry is already paying more than their fair share. As the government continues to add more and more taxes, the airline industry is struggling through its worst financial crisis in history.

Just consider this situation since 1990; the industry has lost a staggering $13 billion, and that is without a fuel tax. The airline industry has laid off almost 120,000 people. The increase in tax equates to the annual cost of compensation for an average of 10,000 employees. The U.S. airlines have either canceled or deferred orders and options on more than 1,000 aircraft, and 125,000 high-paying aircraft manufacturing jobs have been eliminated.

With the exception of Southwest Airlines, every airline has a "junk" credit rating with the capital markets. Even airlines, traditionally considered strong, pay a fortune now to borrow money. In the third quarter of last year, the Standard & Poor's stock index listed the airlines last in the industry groups. The 500 companies in the S&P 500 stock index fall into 88 industry groups. Airlines are listed number 88, dead last.

Notwithstanding this condition, in the past 4 years, virtually every Federal tax or fee imposed on the industry has been increased. In addition, two new fees were added, passenger facility charges and the agriculture inspection fee.

I think many Members of Congress hold the view that these fees do not affect the industry, because they can pass it on to the passenger. The reality is that the pressures of competition is so strong that the airlines have to absorb these fees. Thus, a percentage increase in the mandated fee becomes the same percentage removed from the profitability of the airline. That, I believe is the underlying reason for the $13 billion loss over the past 4 years.

The fuel tax was enacted to help lower the Federal budget deficit. However, some fees paid by the airline industry already go toward supporting government functions and deficit reduction.

For example, the Aviation Trust Fund covers 75 percent of the costs of operations of the Federal Aviation Administration. The customs user fee was increased from $5 to $6.50 to pay for NAFTA, the North American Free Trade Agreement, although aviation rights are not part of the NAFTA Treaty. The passenger ticket tax was increased from 8 to 10 percent in 1990, with 2 percent diverted from the Aviation Trust Fund to the general fund for 2 years to help pay down the deficit.

I also want to mention, Madam Chairman, that this legislation has extremely broad support from businesses throughout the country. I was privileged to a letter not too long back that listed a number of those supporters.

In closing, I want to emphasize that it is time to put a stop to this irresponsible action. The airlines are not cash cows. They are taking aggressive actions to restructure and return to sustained profitability. This is requiring tough choices and difficult sacrifices. Employees have made significant wage and benefit concessions to help provide financial stability for their airlines and their families, and it is beyond all reason to continue to have them pay so much more than their share.

Again, thank you for this opportunity. Ms. Dunn will follow me, and we will both be open to questions from the Committee. Thanks again.

Chairman JOHNSON. Thank you very much for your testimony.

Ms. Dunn.

STATEMENT OF HON. JENNIFER DUNN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WASHINGTON

Ms. DUNN. Madam Chairman, Mr. Matsui and Members of the Committee, it is an honor and a pleasure for me to appear before this Subcommittee to testify on behalf of H.R. 752, a measure that will repeal the commercial jet fuel tax.

Madam Chairman, Mac Collins and I both appreciate the support expressed by this Subcommittee and the Full Committee in supporting our bill. As Mr. Collins said, 19 Full Committee Members support our bill, and 6 Members of this Subcommittee also are sponsors.

I am an original cosponsor of the legislation and a strong supporter of the airline industry. Yet, I cannot begin to express the level of support I feel for this bill. Given the prominence of the Boeing Co. in Washington State, certainly this is a parochial problem for me and for my good friend and colleagues on the Ways and Means Committee, Congressman McDermott. Both of us have many aviation employees who live in our respective districts.

Yet, this is a much larger problem with national implications. It affects millions of citizens through regional job losses and reduced commercial and passenger service.

Mr. Collins and I have compared our testimony, so as not to be too long or redundant. The facts that he presented are accurate and, as accurate as they are, astounding. I would like to offer a few facts of my own.

As Mr. Collins noted, since 1990, 125,000 aircraft manufacturing jobs have been lost. In that period, Madam Chairman, 50,000 of these jobs have come from the Boeing Co., from my part of the country and the largest aviation manufacturer. In February, Boeing announced another 7,000 layoffs, and the Nation's other leading aircraft manufacturer, McDonnell Douglas, announced that it might halt production of its largest airliner, the MD–11. Both McDonnell Douglas and Boeing have had to take such actions because of one simple reason. The domestic airlines cannot afford to purchase many new airplanes.

Madam Chairman, the airlines have lost almost $13 billion—service is being cut, carriers are going under, and others are threatened. Our industrial aviation manufacturing base is under severe stress, and yet the U.S. Government will soon impose an additional tax of over $520 million per year on the industry.

Mr. Collins mentioned that the aviation industry already pays a number of taxes. I would like to list some of those for you, and these are 1994 numbers. The airline industry pays a passenger ticket tax of $4.742 billion a year, a cargo waybill tax of $261 million a year, an international departure tax of $235 million a year, an INS, Immigration and Naturalization Service, user fee of $264 million a year, a customs user fee of $283 million a year, an agriculture inspection user fee of $81 million a year, and in 1994 a passenger facility charge of $782 million a year. They are not trying to escape taxes, Mr. Chairman.

In February, I met with Herb Kelleher, who is the chief executive officer of Southwest Airlines, a company that has been doing reasonably well. His point was both succinct and clear: This new tax which will be imposed beginning October 1 will severely hurt his

currently profitable airline, reduce the ability of Southwest and other carriers to purchase planes from Boeing and McDonnell Douglas, and will severely threaten the viability of other carriers.

Madam Chairman, I hope this Committee will heed the advice of Mr. Kelleher. I pledge to work with you to repeal this dangerous and ill-advised tax.

In fact, Mr. Collins and I have also introduced a bill that will serve as a partial offset for this burdensome airline jet fuel tax, H.R. 1024, the privatization of the Government Printing Office, and that has been given a preliminary scoring by CBO of right around $1.5 billion. Mr. Collins and I have testified in front of the Budget Committee and the Transportation and Infrastructure Committee regarding our plan to remove the jet fuel tax in a fiscally responsible manner.

Madam Chairman, I thank you for this opportunity to appear before the Committee.

[The prepared statement follows:]

Testimony

Congresswoman Jennifer Dunn

Madam Chairman, Mr. Matsui, and Members of the Committee, it is an honor and a pleasure for me to appear before this subcommittee to testify on behalf of H.R. 752, a measure that will repeal the commercial jet fuel tax.

Madam Chairman, Mac Collins and I both appreciate the support expressed by this subcommittee and the full committee in supporting our bill. For the record, 19 Members of the Ways and Means Committee and 6 Members of this subcommittee are cosponsors.

I am an original cosponsor of this legislation and a strong supporter of the airline industry, yet, I cannot begin to express my level of support for this bill. Given the prominence of Boeing in Washington state, this is a parochial problem for myself and my good friend Congressman McDermott. We both have many aviation employees who live in our respective districts.

Yet, this is a much larger problem with national implications. It affects millions of citizens through regional job losses, and reduced commercial and passenger service.

Last night, Mr. Collins and I compared our testimony so as to not be too long or redundant. The facts that he presented are as accurate as they are astounding. But, let me add a few facts of my own.

As Mr. Collins noted, since 1990, 125,000 aircraft manufacturing jobs have been lost. But, Madam Chairman, in that period, 50,000 of those jobs have come from The Boeing Company -- from my part of the country and the largest aviation manufacturer. And in February, Boeing announced another 7,000 layoffs and the nation's other leading aircraft manufacturer, McDonnell Douglas, announced it might halt production of its largest airliner - the MD-11.

Both, McDonnell-Douglas and Boeing have had to take such actions because of one simple reason: the domestic airlines cannot afford to purchase many new planes.

Mr. Madam...the airlines have lost almost $13 billion...service is being cut...carriers are going under and others are threatened...our industrial aviation manufacturing base is under severe stress, and yet, the United States Government will soon impose an **additional** tax of over $520 million dollars per year on the industry.

Let me list the taxes **already being** paid by the airlines:

1994 NUMBERS (Estimated)

TAX OR FEE	AMOUNT	TOTAL REVENUE LOSS
Passenger ticket tax	10%	$4,742,000,000
Cargo waybill tax	6.25%	261,000,000
International departure tax	$6.00	235,000,000
INS user fee	$6.00	264,000,000
Customs user fee	$6.50	283,000,000
Agriculture inspection user fee	$1.45	81,000,000
Passenger facility charges	$3.00	782,000,000
TOTAL		**$6,648,000,000**

1993 NUMBERS

TAX OR FEE	AMOUNT	TOTAL REVENUE LOSS
Passenger ticket tax	10%	$4,472,000,000
Cargo waybill tax	6.25%	255,000,000
International departure tax	$6.00	223,000,000
INS user fee	$5.00	220,000,000
Customs user fee	$5.00	138,000,000
Agriculture inspection user fee	$1.45	74,000,000
Passenger facility charges	$3.00	486,000,000
TOTAL		**$5,868,000,000**

In Februry, I met with Herb Kelleher, CEO of Southwest, an airline that has been doing reasonably well.

His point was both succinct and clear. This new tax, which will be imposed beginning October 1st, will severely hurt his **currently** profitable airline, reduce the ability of Southwest and other carriers to purchase planes from Boeing and McDonnell Douglas, and severely threaten the viability of other carriers.

Madam Chairman, I hope this committee will heed the advice of Mr. Kelleher. I pledge to work with you to repeal this dangerous and ill-advised tax.

Chairman JOHNSON. Thank you very much.
I would like to recognize Hon. Mr. Roth.

STATEMENT OF HON. TOBY ROTH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. ROTH. Thank you, Madam Chairman. I am delighted to join my colleague Mr. Collins, Mr. Houghton, and Ms. Dunn before the Committee this morning.

I am here to testify in support of the permanent exemption for our airlines, the 4.3-cents-per-gallon transportation fuel tax which would be going into effect October 1.

A question was asked here this morning by Mr. Houghton. He asked where are the jobs going to come from. I will tell you where the jobs are going to come from. The jobs are going to come from the area of travel and tourism. With the huge trade deficit we have this year, one area where we have a trade surplus is in the area of foreign tourists coming to the United States. We are getting in about $1.5 billion because of foreign tourists coming here and shopping and giving us that kind of a trade surplus. This is why tourism is so important.

As the Chairman of the Travel and Tourist Caucus, I can tell you that the restaurants, the small stores, small businesses, hotels and service industries in our State of Wisconsin, if we have a good tourism year, we have an additional 147,000 jobs, and that is even more true for Maryland, Michigan, California, Connecticut, Missouri, or Texas. This is true throughout our country, and that is why this has such a tremendous impact on us.

The unreasonable tax that would be imposed on one segment of the travel and tourist industry, the airlines, will cost good paying jobs, essential travel services, and quite possibly will deliver a crushing blow to many of the U.S. carriers struggling to get back on their feet.

As Chairman of the Travel and Tourist Caucus, Madam Chairman and Members of the Committee, I know firsthand how vital our Nation's airlines are to the health of the U.S. economy. Travel and tourism added $127 billion to the national coffers last year. People like you have a tremendous responsibility. I again want to emphasize, $127 billion came into our national coffers because of travel and tourism, and this is many times lost. Travel and tourism adds $127 billion to the national tax coffers, with several billion dollars coming directly from the airlines industry.

In addition to these Federal taxes and other State taxes, the airlines pay over $6 billion in passenger and excise taxes, the equivalent of a 46-cents-per-gallon fuel tax. The airline industry already pays their fair share, as has been so adequately pointed out in the testimony this morning, of the American tax burden. Even under today's Tax Code, the airlines have lost a staggering $12.8 billion in the last 4 years, and that is something I think we have to always keep in mind.

While in recent months the industry has shown small signs of recovering from the $12.8 billion loss, recovery has come only at the sacrifice of 120,000 U.S. airline employee jobs and 125,000 U.S. aircraft manufacturing jobs. Midwest Express, one of the companies that is in my congressional district, has estimated that if the fuel

tax had been in place in 1994, it would have cost the airlines $2 million. That amounts to 22 percent of their total operating revenue for last year alone.

Madam Chairman and Members of the Committee, I think that we have to make sure that the companies pay their fair share, but let us not drive these people out of business. If they do not have any business, we do not have jobs, we do not have jobs in our restaurants and our motels and all across the board. We do not have profits, no jobs, and also no taxes.

This bill acknowledges the sacrifices of airline industry employees who took pay cuts to keep their companies in business. It promotes economic growth and employment in one of our Nation's most dynamic and untapped industries of the travel and tourism industry. For that reason, Madam Chairman and Members of the Committee, I hope that you will agree with the panel here this morning and also with our testimony.

Thank you.

[The prepared statement follows:]

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INTERNATIONAL RELATIONS COMMITTEE
CHAIRMAN
INTERNATIONAL ECONOMIC
POLICY AND TRADE SUBCOMMITTEE

COMMITTEE ON BANKING AND FINANCIAL
SERVICES
FINANCIAL INSTITUTIONS AND
CONSUMER CREDIT SUBCOMMITTEE

United States
House of Representatives

Testimony
Representative Toby Roth
House Committee on Ways and Means
Subcommittee on Oversight

May 9, 1995

Mr. Chairman:

I testify today in support of a permanent exemption for the airlines from the 4.3 cents per gallon transportation fuel tax set to take effect on October 1, 1995.

This permanent exemption is one provision of H.R. 1083, "The Travel and Tourism Relief Act of 1995," which I introduced in the House of Representatives February 28, 1995.

The five provisions of the Travel and Tourism Relief Act are 1.) to permit travel agents independent contractor status, 2.) to restore the meal and entertainment tax deduction from 50 back to 80 percent, 3.) to make permanent the 4.3 percent airline fuel tax exception, 4.) to provide a tax credit for companies promoting the U.S. abroad, and 5.) to allow tax deduction for business meeting held on cruise ships.

All of these provisions are important, but today I want to speak on behalf of provision three, the necessity of of a permanent airline fuel tax exemption.

We all want to make sure that all businesses pay their fair share of taxes, whether it is a large corporation or the Mom and Pop corner store. But all too often, the travel and tourism industry is singled out as the tax collector's cash cow.

And this time, the unreasonable tax that has been imposed on one segment of the tourism industry -- the airlines -- will cost good-paying jobs, essential travel services, and quite possibly will deliver the crushing blow to many of the U.S. carriers struggling to get back on their feet.

With this additional tax, the airline industry will suffer unduly at the hands of the big spenders -- big spenders who intend to spend more than America has and do so at the cost of American workers and American businesses.

As Chairman of the Congressional Travel and Tourism Caucus, I know firsthand how vital our nation's airlines are to the health of the U.S. economy. Travel and tourism adds $127 billion to the national tax coffers, with several billion coming directly from the airline industry.

In addition to these Federal taxes and other state taxes, the airlines pay over $6 billion in passenger and excise taxes -- the equivalent of a 46 cents per gallon fuel tax.

The airlines already pay their fair share of the American tax burden. Even under today's tax codes, the airlines have lost a staggering $12.8 billion during the last four years. This industry is already on less than stable ground.

Even as the airlines struggled just to survive, the Clinton Administration's tax plan of 1993 imposed the 4.3 cents per gallon fuel tax, now scheduled to take effect October 1, 1995.

Mr. Chairman, this tax will cost airlines an additional $527 million a year -- a devastating blow. The cost to the U.S. economy will be even greater.

A healthy U.S. airline industry is critical to the vitality of our nation's economy. The Congressionally-mandated National Airline Commission stated in its 1993 report that to return the industry to profitability, Congress must act to "relieve the airline industry of its unfair tax and user fee burden."

While in recent months, the industry has shown small signs of recovering from its $12.8 billion loss, recovery has come only at the sacrifice of 120,000 U.S. airline employee jobs and 125,000 U.S. aircraft manufacturing jobs.

Employees whose jobs were not eliminated accepted substantial wage and benefit decreases, with total airline industry concessions in excess of one billion dollars annually.

Mr. Chairman, it would be more than an exercise in poor judgement to inflict an additional $527 million tax on an industry and its employees who have struggling so hard to regain financial footing.

This tax is bad public policy.

It will affect us all by upsetting essential aviation services, raising unemployment, increasing ticket prices, and quite possibly by forcing some of our nation's airlines into bankruptcy.

Midwest Express, one of the airlines that services my own district in Northeast Wisconsin, estimated that if this tax had been in place in 1994 it would have cost their airlines $2 million.

That amounts to 22 percent of their total operating revenues for last year alone!

Mr. Chairman, my bill H.R. 1083 makes permanent the exemption of commercial airlines from this job-killing transportation tax.

The National Airline Commission officially stated that the airline industry can not financially absorb another tax hit of this magnitude.

Ladies and Gentlemen, we must make sure companies pay their way, but let's not drive them into the ground.

The Travel and Tourism Relief Act enables the airlines -- a critical segment of the tourism industry -- the opportunity to sustain their economic recovery.

This bill acknowledges the sacrifices of the airline industry employees who took pay cuts to keep their companies in business.

And it promotes economic growth and employment in one of our nation's most dynamic and untapped industries -- travel and tourism.

I urge my colleagues to support the Travel and Tourism Relief Act and to support the jobs of thousands of travel agents, restaurant owners, small businessmen and women and particularly airline employees who are directly at risk with this airline fuel tax.

Chairman JOHNSON. I thank the panel for your excellent comments.

There are a couple of other Members who, for various reasons such as plane schedules, will not be here until later and they will be allowed to testify at that time.

First of all, I do think a healthy airline industry is important to a strong economy. I appreciate the wealth of data that you have presented to us and the fact that you did not allow your testimony to overlap too much.

We will be looking in the course of this hearing at the tax burden on airlines versus other modes of transportation, as well as looking at the broader picture of the role of the airline industry in our economy.

It is also true, however, that when we pass a tax and exempt one industry because of its health, we do that in the context of not looking at the health of carriers in other industries, as well. We do want to look at the equity issues for other modes of transportation in the course of this hearing. You have provided us with excellent information and a fine place to start, and I thank you for that.

Amo, I look forward to the details of your reform proposal. I hope that when the Department of Labor testifies today, that they will have a reform proposal, because they have long said that the current program is not workable and does not accomplish our goals effectively. I share with you the belief that the concept is an important one and am disappointed that to this point the Department of Labor has not come forward with their idea of what reform would represent.

I am pleased that you and Charlie are taking on that task. I would urge you, however, to move forward rapidly, because, as you and I know, decisions about how much we are going to have to raise and what we are going to have to do are going to fall rapidly upon us.

Do other Members of the Committee have questions? Mr. Matsui.

Mr. MATSUI. Thank you, Madam Chairwoman.

I want to thank all four of the Members of the panel, and I also look forward to working with the three of you who talked about the aviation fuel tax.

I would like to touch on Mr. Houghton's targeted jobs tax credit issue. First of all, I want to commend you and Mr. Rangel for trying to reform this particular tax credit. Certainly, I think we learned last year that it is in need of major reform. Unless we do, I cannot see us actually extending it and making it permanent. I think your efforts will go a long way in making sure it does work.

Without getting to specifics, because you have not introduced the bill yet, you are going to raise the threshold from $6,000 to $10,000. Would you perhaps explain why that is? Perhaps it is a little premature yet. If it is, just tell me. If you have the answer to that, could you explain it? Perhaps you could also talk about the possible revenue implications, if in fact, it will be more or less. Again, I know it is early.

Mr. HOUGHTON. Mr. Matsui, there are a couple of reasons for the increase. First of all, inflation has taken its toll. Also, if you multiply 425 times 2,000-plus, you get—I mean it is way out of whack.

It is not a realistic number for the year 1995, so that is primarily why we had to include an increase.

As far as the revenue implications are concerned, I have no idea. I have tried to get some revenue answers. I have not been able to get them. The old program costs about $2 billion over 5 years, actually $1.9 billion, so let us say that averages how many dollars a year. That is one way of looking at it.

The other way of looking at it that has been very tempting to me to explore, is if you take somebody on welfare and you add up all the costs, you get the equivalent of about $12,000 a year. If you compare that to $4,000 a year as benefit for the corporation or net that out with a 35-percent tax rate to about $2,600, The proportions are way off. It does cost money for the government, but in terms of shifting that from the welfare program I think net to net it is a great savings.

Mr. MATSUI. I understand also you are going to shrink the number or the kinds of employees that will actually be able to use the credit, which probably will help reduce the revenues a little bit.

Mr. HOUGHTON. Right.

Mr. MATSUI. Obviously, the main issue is to make sure that when these people are hired under this program, that they become permanent employees, rather than 6 months hired and then later laid off and having the employer take advantage of basically a tax credit. I think that is an issue you are working on now.

Mr. HOUGHTON. Exactly. Imagine yourself running a small operation, and all of a sudden an ex-felon or somebody who has not had a very good record, has been on welfare for a long time, comes up and says I want to get a job. He has no skills. You have got to have a very big heart to be able to take that person on. Frankly a lot of people doing it have worked out. Just this extra nudge, with all the preconditions which we put into this new bill, I think it is really worth a chance.

Mr. MATSUI. Thank you.

Mr. HOUGHTON. Thank you.

Chairman JOHNSON. Do other Members have questions or comments?

Mr. Hancock.

Mr. HANCOCK. My good friend from New York, I would like to ask a question. One of the things I hear in the small business community is, they are very concerned, most businessmen would like to help get people off welfare. It is understood that it is good if they can do this as citizen involvement.

In many cases, though, I have had small businessmen say, look, I just cannot take the risk. I tried it once, and the next thing I knew the guy did not work out. I had the wage and hour people on me. Attorneys were in on it, and it cost me $25,000 in legal fees to get the government off my back, because I was willing to take a risk by hiring this disadvantaged individual.

I am sure that did not work out all the time, but is there some way or could you consider some way to try to control the risk and the liability on the small business community, if in fact they are willing to take on that risk?

Mr. HOUGHTON. I think the agency is going to have to do that. I think if the agency dishes up somebody who has broken into

stores and held up various people and has absolutely no remorse about this thing and is really a high-risk employee, then that is wrong. That will probably happen, but it should not. This is why the tightening up of these preconditions are concerned.

As you know, Mr. Hancock, business is money and you are willing to take a risk if the incentives are there. This is why the incentives are here in this program.

Mr. HANCOCK. A risk that you do not have to take, very few businessmen are going to take it.

Mr. HOUGHTON. If there is no financial incentive to offset the imagined risk in your mind, you are not going to take it, period.

Mr. HANCOCK. I am still saying, though, that if you would consider—I am just asking the question—if you would consider some way to include in your bill some type of relief, some type of protection for the businessman that is willing to take the risk, not because—I am sure there is an incentive to make this successful, but he may be doing it just out of the goodness of his heart. There are people who do things like that.

Thank you very much.

Mr. HOUGHTON. Could I just answer that? If you have got ideas that are not overly burdensome and do not put a tremendous liability on the part of the agency or the government that is doing this, I would love to see it, because I think there are some things that can be changed here. Frankly, maybe a cap should be considered, maybe a sunset provision, maybe things like that. Let me know and I will be willing, and I am sure Mr. Rangel also, to work this into our bill.

Mr. HANCOCK. Thank you very much.

Madam Chairman, I would like to take this opportunity to ask unanimous consent to submit a statement for the record by Sam Fox of Clayton, Missouri, supporting the permanent extension of section 170(e)(5), which prior to expiration permitted a tax deduction for donations of appreciated marketable securities to private foundations. I ask that this statement be included at the appropriate place in the hearing record.

Chairman JOHNSON. Without objection.

Mr. HANCOCK. Thank you, Madam Chairman.

[The prepared statement follows:]

STATEMENT BY SAM FOX OF CLAYTON, MISSOURI WITH RESPECT TO EXTENSION OF IRC SECTION 170(e)(5) REGARDING CONTRIBUTIONS TO PRIVATE FOUNDATIONS

This statement is submitted by and on behalf of Sam Fox of Clayton, Missouri in support of the permanent extension of Section 170(e)(5) of the Internal Revenue Code which, until December 31, 1994, permitted tax deduction (within certain prescribed limits) of donations of appreciated marketable securities to private foundations.

My name is Sam Fox. I reside in Clayton, Missouri. I am the Chairman and Chief Executive Officer of Harbour Group, which, together with its affiliated organizations, manages and owns substantial interests in a number of industrial groups having manufacturing facilities throughout the United States and Europe.

I, together with my wife, are founders of the Fox Family Foundation, a private charitable foundation, qualified as such under Section 501(c)(3) of the Internal Revenue Code.

The Fox Family Foundation is not merely a passive conduit of funds to large public charities. A significant part of its activities involves the active selection of grant recipients, usually small agencies engaged in important social welfare projects, but who do not have the wherewithal to support broad fund solicitations. Each year the Foundation provides grants to more than 150 organizations. Grant recipients include such organizations as the Crusade Against Crime/Child Assistance Program to provide funding to employ a part-time social worker, the St. Louis Community Aging Corporation to provide support services for senior project tenants, the Food Outreach program to help provide food to indigent persons suffering from AIDS, Hamilton Heights Housing for its job training program and the St. Louis Child Abuse Network to employ a family therapist. The Foundation also provides seed money for start up charities such as the Alliance for Mentally Ill/Self-Help Center to cover salaries for a fund raiser and program director.

My wife and I and our five children serve as Trustees of the Foundation. The Foundation has two full-time employees. Its finances are audited by Price Waterhouse and its legal requirements are provided by the law firm of Dickstein, Shapiro & Morin L.L.P. of Washington, D.C.

In the past, funding for Foundation activities has been generally provided by large annual cash contributions by me and my wife. However, in addition to annual cash contributions in support of current activities, we are now seeking to establish a substantial endowment so that the Foundation can maintain continuity in its charitable activities for decades to come. In 1994 my wife and I contributed over $6 million of appreciated, marketable securities to the Foundation. Such securities consisted of common stock of four public companies that had been established by Harbour Group in which my wife and I have very substantial positions.

The expiration of Section 170(e)(5) of the Internal Revenue Code has produced the anomaly that contributions of appreciated stock to public charities are deductible at their fair market value while such contributions to private charitable foundations are not. This works to the disadvantage of small, grass-roots charitable organizations, such as those supported by the Fox Family Foundation, which do not have the staff or infrastructure to manage endowments or even to deal with contributions of securities. I believe there is no valid reason for this discriminatory differentiation between public charities and private foundations. Certainly, the panoply of law, regulations and enforcement mechanisms governing private foundations should preclude any concern over abuse or misuse. Moreover, for the reasons stated, private foundations can operate with an intimate knowledge of community needs that would normally be outside the ken of large public charities.

If Section 170(e)(5) is extended for 1995 and years subsequent, it would be our intention to continue to make similar substantial stock contributions to the Foundation. On the other

hand, if Section 170(e)(5) were not to be extended, our cost basis in such shares is so low that it would make little sense for us to contribute such shares to the Foundation except perhaps by testamentary disposition after the last of us has died. At the very least, this would most probably produce a very long deferral of such contributions and a substantial diminishment of the Foundation's capacity to perform charitable activities which would otherwise be funded at a rate of not less than five percent of the value of the Foundation's retained assets.

I am aware that the Joint Committee on Taxation has earlier estimated that the extension of Section 170(e)(5) would produce a five year revenue loss of some $280 million. Even if that were the case, I believe that the benefits to be derived from the additional charitable activities that extension of Section 170(e)(5) would generate would more than reciprocate for such loss. But if the behavior of other taxpayers in my situation is similar to my own, I question the assumptions on which that presumed revenue loss has been based. For revenue losses would only be incurred if taxpayers owning securities with substantial unrealized appreciated gains would choose to sell those securities and pay capital gains thereon in order to contribute the net cash proceeds to private foundation. I believe this to be highly unlikely particularly in situations that may constitute the bulk of such potential contributions where the prospective donor's holdings in a public company represent a substantial, perhaps controlling, interest in the public company.

Both federal and state budgetary considerations will necessarily diminish, if not preclude, government funding for activities such as those supported by the Fox Family Foundation. Moreover, it is my strongly held belief that funding of such activities is more effectively and less expensively performed by the private sector. Accordingly, I believe that an essential element of government downsizing would be to encourage private charitable giving in every possible way. Certainly, extension of Section

Chairman JOHNSON. Mr. Johnson.

Mr. JOHNSON of Texas. Thank you, Madam Chairman.

Mr. Houghton, I understand that you have got a separate category in your program for high-risk youths. I think there is a lot that would not fall under the means-tested program that needs our attention, and I wonder if you could discuss with me the separate category of high-risk youths as it appears in your plan.

Mr. HOUGHTON. The different categories of people who are eligible?

Mr. JOHNSON of Texas. Yes, high risk.

Mr. HOUGHTON. There are basically two. There is the group between 18 and 12, it used to be lower than that, who were either on public assistance or have a very good chance of getting on public assistance. There is this high-risk youth category from 16 to 21 years of age. About 75 percent come from the high-risk youth category. Those are the two basic categories.

Mr. JOHNSON of Texas. Those high-risk guys are those who have been without working role models, perhaps they are unskilled and oftentimes youth that turn to drugs and violence. I guess the program that you propose is supposed to provide them with some training and role models in the workplace which theoretically would—you know, they would otherwise be at risk of no economic recovery.

Mr. HOUGHTON. That is right. As you know, when we discussed the welfare bill, there is really no training until you have a job. If the incentive is there, the job is there, the AFDC Program comes in and really helps these people. There are so many of these training programs, they are going to try to boil them down from about 133 down to 1, so it is going to be expensive, but that is where that kicks in.

The end result you hope is to make a worthwhile solid individual out of somebody who is just on the brink all the time.

Mr. JOHNSON of Texas. Thank you, Mr. Houghton.

Mr. HOUGHTON. Thank you.

Mr. JOHNSON of Texas. Thank you, Madam Chairman.

Chairman JOHNSON. Thank you very much for your input today.

I would just add to my opening statement while Members are here this proviso. While I did recognize that we may be forced to consider temporary extensions, I think the whole concept of a balanced budget proposal, of the Congress taking on the responsibility of reaching some kind of balance between revenues and expenditures in 7, 8, or even 10 years means that we have an obligation right now to say this is the tax policy that we think will support services and a vital economy in that period and to pay for those things.

Temporary extensions do not do that. I personally feel a certain obligation to prefer permanence over temporary, because I think it is a more honest reflection of our commitment to setting out a spending path that reaches balance by the year 2002, but also encompasses both a spending policy and a tax policy that we believe will support a strong economy.

We will be putting a heavy emphasis on permanency and we will be looking at the alternatives to accomplishing the goals of the tax

provisions that people support. I invite your continued work with us as we go through this process.

Thank you for your excellent testimony this morning.

Mr. COLLINS. Thank you, Madam Chairman. I would like to emphasize, too, that we feel very strongly about the fact that we must work toward a balanced budget by the year that we have promised the public we would do so, and that is the year 2002. That is the reason it is done. I have identified some 40 billion dollars' worth of possible rescissions or changes in Tax Code offsets and spending that would help us pay for the assistance that we are trying to grant to the airline industry. We feel like a repeal of this upcoming tax will probably be much more beneficial in the long run. With the repeal and implementation of it from the standpoint of the operation of the airlines, their profits and the employees and the wages they earn and the taxes that are deducted from their wages, and also those who are affiliated with the airline industry through the airports and manufacturing or catering or whatever the other offset business or outside business may be.

We welcome the opportunity to offer offsets, and we welcome the opportunity to work toward a balanced budget. It will be very prosperous to this Nation the day that we reach zero deficit.

Thank you.

Chairman JOHNSON. Thank you.

I thank the panel and call the next panel. The next panel is the Deputy Assistant Secretary for Tax Policy of the Department of the Treasury, Cynthia Beerbower; also Hon. Doug Ross, Assistant Secretary for Employment and Training of the Labor Department; and Patrick Murphy, Acting Assistant Secretary for Aviation and International Affairs of the U.S. Department of Transportation.

Normally, as Committee Members know, I think it is only fair to indulge the administration witnesses, because I think your long experience is terribly important to us. However, because we have so many panels, I will have to also ask you to be as targeted in your remarks as you can be. I assure you that we will be willing to work with you throughout this process, but I would appreciate it if you focus your remarks as much as you can, and if the Committee Members will also try to focus their questions.

We will first hear from Ms. Beerbower, of the Treasury Department.

STATEMENT OF CYNTHIA G. BEERBOWER, DEPUTY ASSISTANT SECRETARY FOR TAX POLICY, U.S. DEPARTMENT OF THE TREASURY; ACCOMPANIED BY ELIZABETH WAGNER, STAFF ASSISTANT

Ms. BEERBOWER. Thank you, Madam Chair and distinguished Members of the Subcommittee.

I am pleased to present the views of the administration on the extension of the expiring tax provisions that are the subject of your hearings today, as well as tomorrow, and we thank the Subcommittee for allowing us to consolidate our comments for both days into one testimony.

The administration has supported and continues to support the revenue neutral extension of many of these provisions, and we look forward to working with this Congress in order to meet that goal.

I was pleased to hear your comments, Mrs. Johnson, just a few moments ago about the importance of permanent extension. As a matter of tax policy and consistent with our position in 1993, the administration believes that any extension of the provisions generally should be made permanent, particularly the research tax credit and the orphan drug tax credit, where temporary extensions create great uncertainty and make it very difficult for taxpayers to engage in long-term research decisions.

Temporary extensions create a host of complexities and administrative burdens for taxpayers, particularly when they are allowed to expire, as is the case with some of these provisions today, and then they are reinstated retroactively. Nevertheless, the administration is mindful of budgetary constraint. In considering the permanent extension of all of these incentives, we are happy to work with Congress on a bipartisan basis to develop financing options to pay for them.

The first provision I would like to address is the exclusion for employer-provided educational assistance. The administration supports the extension of the exclusion for employer-provided educational assistance. The exclusion, we believe, encourages employers to provide educational assistance, and it thereby increases our Nation's work force productivity.

In addition, the absence of the exclusion would impose significant administrative burdens on employers, workers and the IRS, Internal Revenue Service, who would need to distinguish between job related expenses, which are excludable from gross income under current law when paid by the employer and other employer-provided educational expenses which are not excludable and, therefore, among other reporting requirements, are subject to wage withholding.

Education and training of our work force is a high priority for this administration. In addition to the employer incentives set forth in this provision, the administration in the Middle-Class Bill of Rights has proposed a deduction for middle-income families for postsecondary education and training expenses.

Second, is the research tax credit. The administration consistently has supported the research tax credit and has recommended its permanent extension in 1993 for the 1994 budget. Unfortunately, that did not occur in Congress and it was only temporarily extended.

Again, in the administration's 1996 budget, we continue to support the permanent extension of the research tax credit. We recognize the importance of technology to our national ability to compete in what is now a very global marketplace. The research tax credit is a vital tool in developing, supporting and fostering American technology.

Third, the administration supports the permanent extension of the orphan drug tax credit. This credit has been helpful in making new drugs available for those suffering from rare diseases. The development of these drugs might not occur without the credit, since the low rate of return on sales of specialized drugs generally cannot justify the extensive research by biotechnology and pharmaceutical companies to develop them.

Fourth, the administration supports reinstating the full fair-market value deduction for gifts of qualified appreciated stock to private foundations. Private foundations perform an important role in funding the charitable sector. As the government reinvents, restructures and reduces in size, the charitable sector will be expected to take on the financial burden of an increasing number of public projects.

Thus, charitable giving needs to be encouraged. We believe that allowing the full fair-market value deduction for gifts of qualified appreciated stock will encourage the formation and funding of private foundations and will enable the charitable sector to better fund its increasing responsibilities.

Fifth, as stated in the President's 1996 budget, the administration supports the revenue neutral extension of section 864(f). In 1992, the Treasury undertook to study the allocation methodology for allocating research and experimentation costs between foreign source and domestic source income.

I am happy to say this morning that this study is nearly completed. In fact, we were hoping to be able to release the regulations this morning. We will shortly announce these regulations. One thing I can say about them is they are likely to be more favorable to taxpayers than the 1977 regulations.

Sixth, the administration opposes any general extension of the tax credit for producing fuel from nonconventional sources. When Congress enacted this credit, an objective was to support the development of new alternative technologies to recover oil and gas. The credit was intended to apply for a limited period of time only, after which Congress expected that no special incentive would be needed for the affected industries, since they would have matured and become competitive without government assistance over the life of the credit.

The 1992 extension for biomass and coal facilities was intended to be a transition rule for taxpayers with facilities that were soon to be placed in service. This transition period is now almost over, and we believe that a further extension is not warranted.

The administration also opposes any delay in the effective date of the 4.3-cents-per-gallon excise tax on fuel used in commercial aviation. When Congress increased the excise tax on fuels used in transportation, the intention was that all modes of transportation would be equally subject to this excise tax. The effective date of the tax on commercial aviation was delayed for 2 years because of the concerns that the commercial airlines industry generally was experiencing industry-wide losses.

Today's economic picture is different. As the economy has recovered from the recession, air traffic has increased and most airlines have experienced improvements in their financial condition. Thus, the industry is now in a better position to accommodate an excise tax of 4.3-cents-per-gallon on commercial aviation fuel. This tax is well within the range of the jet fuel prices over the last couple of years, and that type of fluctuation should be easily accommodated by the industry and has in fact been accommodated through the price fluctuations.

The employment of economically disadvantaged and disabled workers is undoubtedly one of the administration's most pressing

concerns. As Treasury testified last fall, however, there are problems with the targeted jobs tax credit that undermine its effectiveness. Because we are very concerned about the efficient use of government revenues, we believe that the problems undermining the credit's effectiveness must be addressed before pursuing an extension of this credit.

The Labor Department will discuss this further, but in August 1994 the findings by the Labor Department's Office of Inspector General were critical of the credit's effectiveness. My written testimony highlights a couple of the credit's problems and it offers general options for addressing these concerns. The Treasury Department looks forward to working with Congress on a bipartisan basis to address these problems that currently undermine the credit's effectiveness.

This concludes my prepared remarks, but I will remain until the other panelists have finished for questions.

Thank you.

[The prepared statement and attachment follow:]

STATEMENT OF
CYNTHIA G. BEERBOWER
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Madam Chair and distinguished Members of the Subcommittee:

I am pleased to present the views of the Treasury Department today on the extension of various expired or expiring tax provisions set forth in the Subcommittee's Notice of Hearing dated April 19, 1995.

As discussed in more detail below, the Administration has previously supported and continues to support the revenue-neutral extension of many of these expired or expiring tax provisions, and looks forward to working with this Subcommittee to achieve that goal. These provisions include the exclusion for employer-provided educational assistance, the research tax credit, the tax credit for orphan drug clinical testing expenses, the tax deduction for contributions of qualified appreciated stock to private foundations, and the rules regarding allocation of research expenditures. The Administration would also support the extension of the targeted jobs tax credit if the problems underlying the credit's effectiveness were addressed.

As a matter of tax policy, the Administration believes that any extensions of tax incentives generally should be made on a permanent basis. Temporary extensions undercut the desired incentive by creating uncertainty and making it difficult for taxpayers to make long-term business plans. Temporary extensions also contribute to complexity for taxpayers and may create administrative problems when the provisions are allowed to expire and are then reinstated retroactively. Nevertheless, the Administration is mindful of budgetary constraints in considering permanent extensions of these incentives. The Administration is happy to work with the Congress on a bipartisan basis in developing acceptable options for financing these extensions. (Attachment A shows the receipts effect of permanent extension of the expiring provisions.)

The Administration opposes extending the delayed effective date of the 4.3 cents per gallon tax on commercial aviation fuel enacted as part of the Omnibus Budget Reconciliation Act of 1993

(OBRA 1993). The Administration also opposes extension of the production credit for nonconventional fuels.

In addition to the various expiring provisions that are the subject of this hearing today, several other provisions of the tax code either have already expired or are scheduled to expire soon. As indicated in the Administration's Fiscal Year 1996 budget, the Administration supports extension of these provisions, which are described below:

-- Oil spill liability tax. Under prior law, a 5 cents per-barrel tax was levied on each barrel of domestic and imported crude oil entering a U.S. port. This tax, which was deposited in the Oil Spill Liability Trust Fund, was to expire on the earlier of December 31, 1994, or the date on which the unobligated balance in the fund reached $1 billion. This tax expired on December 31, 1994.

-- Generalized system of preferences (GSP). Under GSP, duty-free access is provided to over 4,000 items from about 142 eligible developing countries that meet certain worker rights and other criteria. This program, which was extended for 10 months under the Uruguay Round Agreements Act of 1994, is scheduled to expire after July 31, 1995.

-- Environmental tax on corporate taxable income. A tax equal to 0.12 percent of alternative taxable income in excess of $2 million is levied on all corporations and deposited in the Hazardous Substance Superfund Trust Fund. This tax expires on December 31, 1995. In addition, the Administration also supports extension of the excise taxes deposited in the Superfund, which are scheduled to expire December 31, 1995. These environmental excise taxes are the crude oil tax (9.7 cents per barrel for domestic crude oil and imported petroleum products), the tax on feedstock chemicals, and the tax on certain imported substances.

The Administration's detailed views regarding the expiring provisions that are the subject of today's hearings follow.

1. Exclusion for Employer-Provided Educational Assistance

Background

The exclusion for employer-provided educational assistance was first enacted on a temporary basis as part of the Revenue Act of 1978. It has been extended seven times. In its Fiscal Year 1994 budget, the Administration proposed permanently extending the exclusion for employer-provided educational assistance. OBRA 1993, however, provided only a temporary extension. The exclusion expired for taxable years beginning after December 31, 1994.

Current Law

Prior to expiration, section 127 provided that amounts paid by an employer with respect to an employee under an educational assistance program were excluded from the employee's gross income and wages for employment tax purposes to the extent that the value of the assistance did not exceed $5,250 per year, regardless of whether the expense would otherwise be deductible. Such programs were subject to nondiscrimination rules to ensure that the assistance was not provided primarily to higher-paid employees.

Education expenses incurred directly are deductible only if the education is related to the person's employment, and then only as a miscellaneous itemized deduction subject to the two percent of adjusted gross income floor. A deduction for education expenses is allowed only if the education maintains or improves a skill required in the individual's employment or other trade or business, or is required by the individual's employer, or by law or regulation for the individual to retain his or her current job.

Employer reimbursement of such expenses, however, may be excluded from income as a working-condition fringe benefit under section 132(d), and, unlike education expenses paid for by the employee, is not subject to the two-percent floor, nor is the deduction subject to a ceiling. The educational expense, however, must be job-related.

In the absence of section 127, the value of employer-provided educational assistance is included in an employee's income and employment-tax wages unless the cost of the assistance would qualify as a deductible, job-related expense of the employee if the employee had incurred the expense directly.

Administration's Recommendation

As stated in the Administration's Fiscal Year 1996 budget, the Administration supports extension of the exclusion for employer-provided educational assistance on a revenue-neutral basis.

The exclusion encourages employers to provide educational assistance and thereby increase the nation's productivity. In addition, the absence of the exclusion would impose significant administrative burdens on employers, workers, and the IRS in distinguishing between job-related expenses (which are excludable from gross income under current law when paid by the employer) and other employer-provided educational expenses.

As noted above, absent the exclusion, the value of employer-provided educational assistance is excludable from gross income

only for employment-related educational expenses. Because of the breadth of prior training and current job responsibilities, employer-provided education benefits provided for higher-income, higher-skilled employees are more likely to qualify as employment-related and thus be deductible regardless of the extension of section 127. In contrast, the educational objectives of lower-income, lower-skilled employees are more likely to include associate or undergraduate degrees and training for new employment, which do not qualify for exclusion in the absence of section 127.

2. Research Tax Credit

Background

The research tax credit initially was enacted as part of the Economic Recovery Tax Act of 1981 and was scheduled to expire on December 31, 1985. The Tax Reform Act of 1986 modified the credit and extended it through December 31, 1988. The credit was further modified and extended by the Technical and Miscellaneous Revenue Act of 1988 (extension through December 31, 1989), and the Omnibus Budget Reconciliation Act of 1989 (extension through December 31, 1990), which also modified the method for calculating a taxpayer's base amount. The credit was subsequently extended by the Omnibus Budget Reconciliation Act of 1990 (extension through December 31, 1991), the Tax Extension Act of 1991 (extension through June 30, 1992), and the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993) (retroactive extension from July 1, 1992 through June 30, 1995). The credit is currently scheduled to expire on June 30, 1995.

Current Law

The research tax credit applies on an incremental basis to a taxpayer's "qualified research expenditures" for a taxable year. The credit is equal to 20 percent of the amount by which the taxpayer's qualified research expenditures for the taxable year exceed a base amount. The base amount is the product of the taxpayer's "fixed base percentage" and the average of the taxpayer's gross receipts for the four preceding years (subject to a maximum rate of .16). The base amount cannot be less than 50 percent of the taxpayer's qualified research expenditures for the taxable year.

For most taxpayers, the fixed based percentage is the ratio of the taxpayer's qualified research expenditures to its gross receipts during the period from 1984 until 1988. For certain

"start-up companies," the fixed base percentage is determined under special rules added by OBRA 1993.[1]

Qualified research expenditures consist of (1) "in house" expenses of the taxpayer for research wages and supplies used in research, (2) certain time-sharing costs for computer use in research, and (3) 65 percent of amounts paid by the taxpayer for contract research conducted on the taxpayer's behalf. To be eligible for the credit, research must be undertaken for the purpose of discovering information which is technological in nature, the application of which is intended to be useful in the development of a new or improved business component of the taxpayer, and must relate to functional aspects, performance, reliability or quality of a business component. Research does not qualify for the credit if it is conducted after the beginning of commercial production of the business component, if it is related to the adaptation of an existing business component to a particular customers requirements or need, or if it is related to the duplication of an existing business component from a physical examination of the component itself (or from similar information such as blueprints). Similarly, qualified research does not include efficiency surveys, market research or development, routine quality control, or research in the social sciences, arts, or humanities.

The credit does not apply to research conducted outside the United States, or to research funded by another person or governmental entity.

Administration's Recommendation

The Administration has consistently supported the research tax credit and included a proposal for its permanent extension in the 1994 budget. As indicated in the Administration's budget for Fiscal Year 1996, we continue to support the revenue-neutral extension of the research tax credit.

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[1]Under these rules, a taxpayer's fixed base percentage is set at .03 for the first five taxable years after 1993 in which the taxpayer incurs qualified research expenditures. For the next five years (assuming extension of the credit), the fixed base percentage is phased-in based on the taxpayer's actual ratio of qualified research expenditures to gross receipts. Thereafter, the percentage is based entirely upon the taxpayer's actual ratio for any five years selected by the taxpayer from its fifth through tenth taxable years after 1993.

Prior to amendment by OBRA 1993, a start-up company's fixed base percentage was set at .03 for all years.

The Administration recognizes the importance of technology to our national ability to compete in the global marketplace. Fostering the development of new technology is a cornerstone of our economic and national security strategy. We are committed to working with the private sector to enhance the role that technology plays in promoting competitiveness, creating high-wage jobs, maintaining America's defense capabilities, improving our quality of life, and fostering sustainable development.

The research tax credit is one tool that could be useful in supporting and fostering American technology. The credit provides incentives for private-sector investment in research and innovation that can help increase America's economic competitiveness and enhance U.S. productivity. These incentives are particularly important, as the U.S. economy becomes increasingly reliant on technological know-how, because private-sector investment in research often creates benefits for the economy that are not captured by an individual company.

The Administration continues to believe that for the research tax credit to be most effective, it should be made permanent, to provide taxpayers with greater certainty in making long-range business plans. It is also important that the cost of any extension of the research tax credit be fully offset. Increasing the Federal deficit could have an adverse impact on research expenditures (by drawing capital away from private-sector investments) and could thus offset the benefits resulting from the extension of the research tax credit.

3. Orphan Drug Tax Credit

Background

An orphan drug tax credit was first enacted as a part of the Orphan Drug Act of 1983. The Act's purpose was to provide incentives and direct Federal grant support for developing drugs for rare diseases and conditions. In addition to the incentive of a 50 percent credit for the expenses of clinically testing drugs for rare diseases, the Act also provided a seven-year exclusive marketing period for rare disease drugs approved for use by the Food and Drug Administration (FDA).

Under the 1983 Act, a "rare disease or condition" was defined as any disease or condition which occurs so infrequently in the United States that there is no reasonable expectation that the cost of developing and making available in the United States a drug for such disease or condition will be recovered from sales in the United States. This facts-and-circumstances test proved difficult to administer and, as a part of the Tax Reform Act of 1986, the definition was expanded to include any disease or condition which affects less than 200,000 persons in the United States.

This credit was originally scheduled to expire at the end of 1987, but was subsequently extended to the end of 1990 by the 1986 Act; to the end of 1991 by the Omnibus Budget Reconciliation Act of 1990; to June 30, 1992 by the Tax Extension Act of 1991; and to December 31, 1994 by the Omnibus Budget Reconciliation Act of 1993.

Since the inception of the orphan drug program, FDA has made (through March 31, 1995) 598 designations of orphan drugs related to particular diseases or conditions (some drugs have been designated with respect to more than one disease or condition). Of these orphan drugs, 104 have been approved for marketing. Included among the diseases and conditions for which marketing approval has been given are metastatic renal cell carcinoma; advanced adenocarcinoma of the ovary; tuberculosis infections; intractable spasticity caused by spinal cord injury or diseases; and hairy cell leukemia. About 20 percent of the approved drugs are to treat children.

Current Law

Prior to its expiration at the end of 1994, the orphan drug tax credit equaled 50 percent of qualified clinical testing expenses for drugs being tested under an exemption for a rare disease or condition under section 505(i) of the Federal Food, Drug, and Cosmetic Act. The testing must occur after the drug is designated under section 526 of the Act and before the drug is approved for use. Expenses funded by a government grant or by any person other than the taxpayer do not qualify. Qualified clinical testing expenses are taken into account in determining base period research expenses, but not qualified research expenses for purposes of the credit for increasing research activities (the R&E credit). The orphan drug tax credit can offset regular income tax liabilities entirely, but cannot be used to reduce alternative minimum tax liabilities. Amounts normally deductible as a business expense are reduced by the amount of any credit claimed. The credit cannot be claimed by any corporation that has elected the section 936 possessions tax credit.

Administration's Recommendation

As indicated in the Administration's Fiscal Year 1996 budget, the Administration supports making the orphan drug tax credit permanent, subject to identifying acceptable revenue offsets for any package of extensions, and will work with the Congress to achieve that goal. As a complement to other provisions of the Orphan Drug Credit Act, this credit, as noted above, has been helpful in making new drugs for rare diseases and conditions available to the least fortunate among us, those suffering from rare diseases but whose numbers are insufficient to provide adequate market incentives for developing remedial

drugs. If this provision is extended, one option to consider is making the credit permanent, so that developers of potential new drugs, when they make initial commitments of venture capital, can plan on the credit being in place if their research is successful to the point of securing FDA approval for clinical trials. The Administration would be willing to consider allowing excess orphan drug credits to be carried forward or backward, as a means to allow smaller drug firms to take advantage of this provision.

4. Full Fair-Market Value Deduction for Gifts of Qualified Appreciated Stock

Background

In the Deficit Reduction Act of 1984, Congress enacted section 170(e)(5), which provided a full fair-market value deduction for gifts of qualified appreciated stock to private foundations. At the time section 170(e)(5) was enacted, taxpayers who donated appreciated property to private foundations were permitted a deduction for their adjusted basis in the property plus sixty percent of the appreciation. This benefit for property other than qualified appreciated stock was eliminated as part of the Tax Reform Act of 1986. The House report accompanying the qualified appreciated stock legislation explained that improved treatment for gifts of all kinds to private foundations was warranted to acknowledge "the substantial role of nonoperating foundations in private philanthropy." It added that the publicly traded stock proposal was appropriate because it offered little potential for abuse.

The full fair-market value deduction for gifts of publicly traded stock expired on December 31, 1994.

Current Law

Prior to its expiration, section 170(e)(5) allowed a taxpayer who contributed qualified appreciated stock to a private foundation to deduct the full fair market value of the contributed stock, rather than the adjusted basis of the contributed stock. Qualified appreciated stock is defined as stock for which a market quotation is readily available and which has been held for more than one year (i.e., long-term capital gain property). This special treatment applies only to the extent that the qualified appreciated stock does not exceed 10 percent of the total outstanding stock of the corporation.

Section 170(e)(5) is an exception to the general rules on gifts of appreciated property to private foundations, which currently allow a deduction only for the donor's adjusted basis in the contributed property. By contrast, the rules on gifts of appreciated property to public charities generally allow a deduction for the full fair-market value of contributed long-term

capital gain property. (If a donor gives appreciated tangible personal property to a public charity which does not use it to further its exempt purposes, a deduction is allowed only for the donor's adjusted basis in the property.)

Administration's Recommendation

As set forth in the Administration's budget for Fiscal Year 1996, the Administration recommends reinstating the full fair market value deduction for gifts of qualified appreciated stock to private foundations, provided that it can be done on an acceptable revenue-neutral basis.

Private foundations perform an important role in the charitable sector. They provide grants and funding for charitable projects that they believe are promising. Thus, encouraging the formation and funding of private foundations through the full fair-market value deduction for gifts of qualified appreciated stock works to the benefit of the charitable sector as a whole.

Allowing a full fair-market value deduction for gifts of publicly traded stock to private foundations encourages taxpayers to devote the stock exclusively to charitable purposes. As government is restructured and reduced in size, the charitable sector will be expected to take on an increasing number of publicly beneficial projects. This incentive for charitable giving will help prepare for that future.

5. Targeted Jobs Tax Credit

Background

The TJTC was enacted by the Revenue Act of 1978 as a substitute for what had been a broad-based new jobs tax credit. Congress concluded that the unemployment rate had declined sufficiently so that it was appropriate to focus employment incentives on individuals with high unemployment rates and other groups with special employment needs.

The credit initially was scheduled to expire on December 31, 1981 and applied to wages earned in the first and second years of employment. The first-year credit was equal to 50 percent of the first $6,000 earned by a TJTC-hire and the second-year credit was 25 percent of the first $6,000 earned.

The TJTC has been extended on a short-term basis numerous times over the years. Revisions also have been made by a number of tax laws to adjust the amount of the credit, close loopholes, and alter the targeted groups of individuals covered by the credit.

The TJTC was amended and extended for one year through December 31, 1982, by the Economic Recovery Tax Act of 1981. This Act eliminated retroactive certification of employees already on the payroll and also required that one targeted group -- cooperative education students -- be economically disadvantaged in order to be covered by the credit. Without this constraint, employers were able to receive subsidies for hiring individuals they likely would have hired in the absence of the credit. Other changes made by the 1981 Act included increasing the number of targeted groups and modifying certain restrictions on eligibility within existing categories.

The TJTC was extended for two more years through December 31, 1984, by the Tax Equity and Fiscal Responsibility Act of 1982. This Act extended the credit to employers hiring economically disadvantaged 16- and 17-year-olds for summer employment. The 1982 Act also deleted one of the targeted groups -- former public service employment participants under the Comprehensive Employment and Training Act.

The Deficit Reduction Act of 1984 extended the TJTC for another year through December 31, 1985, after which it expired. It was extended retroactively for three more years through December 31, 1988, by the Tax Reform Act of 1986. The 1986 Act reduced the amount of the credit to 40 percent of the first $6,000 earned and eliminated the second-year credit. Employees also were required to work for a minimum of 90 days or 120 hours to be covered by the credit (14 days or 20 hours for summer youths). A minimum employment period was imposed to limit the "churning" of employees by some employers. "Churning" involves maximizing the amount of credit by rapidly turning over workforce to hire additional targeted members.

The Omnibus Budget Reconciliation Act of 1987 eliminated the credit for wages paid to individuals who perform duties similar to those of workers who are participating in or are affected by a strike or lockout. The Technical Corrections and Miscellaneous Revenue Act of 1988 extended the credit for an additional year through December 31, 1989; reduced the summer youth credit from 85 percent to 40 percent of the first $3,000 earned; and eliminated 23- and 24-year-olds from the targeted group of economically disadvantaged youths.

The TJTC was extended for nine more months through September 30, 1990, by the Omnibus Budget Reconciliation Act of 1989. This Act also reduced the burden placed on local Employment Service offices of verifying worker eligibility. The 1989 Act required employers requesting certification of a job applicant for which there had not been a written preliminary determination of eligibility (a voucher) to specify at least one, but not more than two, targeted groups to which the individual might belong. The employer also had to certify that it had made a good faith

effort to determine the individual's eligibility. The prior practice of asking local Employment Service offices to verify TJTC-eligibility of all new hires burdened these offices without creating new jobs. The employer firms already had decided to hire the individuals, although the individuals had not yet been put on the payroll.

The Omnibus Budget Reconciliation Act of 1990 retroactively extended the TJTC for 15 months through December 31, 1991. The conference agreement also clarified the definition of one of the targeted groups. This group -- "ex-convicts" -- was defined to include persons who are placed on probation by State courts without a finding of guilty. The TJTC was further extended for six months through June 30, 1992, by the Tax Extension Act of 1991.

Most recently, the credit was extended retroactively for 30 months by the Omnibus Budget Reconciliation Act of 1993. The 1993 Act extended the TJTC to cover individuals who begin work for an employer after June 30, 1992 and before January 1, 1995.

Current Law

Before its expiration, a TJTC was available to employers for up to 40 percent of the first $6,000 of wages paid to a certified worker in the first year of employment. This translates into a potential credit of $2,400 per targeted worker. The worker must be employed for at least 90 days or work at least 120 hours. (The credit for summer youth is 40 percent of the first $3,000 of wages, or $1,200, and these individuals must work for 14 days or 20 hours.) The employer's deduction for wages is reduced by the amount of the TJTC.

Certified workers must be economically disadvantaged or disabled individuals in one of nine targeted groups. These groups are (1) youth 18-22 years old; (2) summer youth age 16-17; (3) cooperative-education students age 16-19; (4) ex-offenders; (5) Vietnam-era veterans; (6) vocational rehabilitation referrals; and individuals receiving (7) general assistance, (8) Supplemental Security Income, or (9) Aid to Families with Dependent Children.

For purposes of the TJTC, a worker is economically disadvantaged if the worker's family income is 70 percent or less of the "lower living standard income level." This level is revised periodically to account for changes in the Consumer Price Index and varies by geographic and urban area.

To claim the credit for an employee, an employer must receive a written certification that the employee is a targeted group member. Certifications for employees are generally provided by State Employment Security Agencies. The employer

must have received or filed a written request for a certification on or before the date a targeted member begins work. If the employer has received a written preliminary determination that the employee is a member of a targeted group, the employer may file a written certification request within five calendar days after the targeted group member begins work.

The TJTC is jointly administered by the Treasury Department through the Internal Revenue Service (IRS) and the Department of Labor through its Employment Service. The IRS is responsible for tax-related aspects of the program and the Employment Service, through the network of State Employment Security Agencies, is responsible for defining and documenting worker eligibility.

Administration's Recommendation

The employment of economically disadvantaged and disabled workers is one of the Administration's most pressing concerns. Because we are very concerned about the efficient use of government revenues and the need to find revenue offsets, however, we believe that the problems undermining the credit's effectiveness must be addressed before pursuing an extension of the credit.

The most recent example of criticism of the program is an August 1994 report by the Labor Department's Office of Inspector General. The Inspector General's report raises significant concerns regarding the effectiveness of the credit. Although the report notes that the TJTC provides some benefits, the report concludes that the TJTC is not cost-effective and recommends that the Secretary of Labor discourage further extensions of the credit.

I would like to highlight three of the credit's main problems and offer very general options and principles for addressing those concerns. These problems are that the credit (1) provides a windfall to employers, (2) subsidizes short-term employment, and (3) promotes only limited training of employees for advanced career positions.

A. Employer windfall

Perhaps the most significant problem with the TJTC is that it often provides a "windfall" to employers. The credit provides a windfall to the extent it confers a benefit on employers for doing what they would have done without that benefit.

The most direct way to reduce any windfall is to require certification of eligibility before the hiring decision is made. In this way, the TJTC can serve as an incentive in the hiring decision. We are mindful that pre-hiring certification may be perceived as conferring a stigma on job applicants. However, the

TJTC was designed to overcome any negative employer perception about the likely productivity of targeted workers by rewarding employers for hiring them. In order for the program to work effectively, employers need to be aware that they are hiring targeted workers at the time the hiring decision is made. A pre-certification system would ensure that the credit was limited to employers that knowingly hired targeted workers.

One drawback of a pre-certification system is that it would place a larger burden on the Employment Service Agencies that perform the certifications. Treasury would be very wary, however, of endorsing any "self-certification" system under which individuals or their employers would certify targeted status with reduced oversight by government agencies. We would be concerned that such an "honor system" is too susceptible to abuse to be workable. Under the current regime, the principal checks against abuse are that Employment Agencies make the certifications and their actions are subject to audit by the Department of Labor. We believe these checks are important to curbing potential abuse and should not be replaced by more lax measures.

B. Employee turnover

Another serious criticism of the TJTC is that it subsidizes short-term positions that are less likely to promote job skills that are beneficial to more advanced job positions.

The Treasury and Labor Departments have explored two broad approaches to the churning problem. Under one approach, churning would be curbed by increasing the number of hours an employee must work with an employer before his or her wages could be taken into account in computing the credit. The current minimum employment period, which is the lesser of 90 days or 120 hours, translates into as little as three weeks of full-time work.

The other approach would "backload" the credit. Under current law, the credit is 40 percent of the first $6,000 in wages paid to a targeted individual. Under the backloading approach, the credit rate applying to wages above some threshold would be higher than the credit rate applying to the initial wages. This shifts the incentive of employers in the direction of paying higher wages and keeping their employees on the job longer.

There are possible downsides to these reform proposals, such as a reduction in the initial hiring incentive and increased administrative burdens that would need to be considered.

C. Training of employees

To the extent the TJTC influences hiring and retention decisions, it helps hard-to-employ individuals develop basic job

skills. These include such fundamental skills as showing up for work on time, taking directions from managers, asking questions when instructions are not clear, and successfully completing assigned tasks. Nevertheless, the low-wage jobs traditionally subsidized by the credit typically do not offer more extensive training that could directly serve as a springboard to more advanced job positions.

To bolster the TJTC's impact on training, the Department of Labor has suggested that the credit might be expanded to apply to individuals participating in approved "school-to-work" programs. Although it is appropriate that a broad range of options be considered, attempts to redesign the TJTC to encourage training present special challenges. Any broad training initiative in the TJTC should attempt to ensure that the credit's special emphasis on hiring economically disadvantaged individuals is retained. A broad-based training option also could lose significant revenue because of the size of the potentially eligible population.

Before extending the TJTC to school-to-work participants, it also would be necessary to understand the relationships of this possible category to existing categories and the precise criteria used in establishing eligibility. We would also need to evaluate whether redesigning the TJTC to include a new training component is allocating government resources to programs that work the best.

6. Tax Credit for Producing Fuel From Nonconventional Sources

Background

As originally enacted in 1980, the nonconventional fuels production credit was available for qualified fuels produced domestically from a well drilled or a facility placed in service before January 1, 1990, and sold to an unrelated person before January 1, 2001. In 1988, the placed-in-service date for both wells and facilities was extended to January 1, 1991. In 1990, the placed-in-service date for both wells and facilities was extended to January 1, 1993, and the production-credit sunset date was extended, so that sales of qualifying fuels occurring before January 1, 2003, would be eligible for the credit.

The Energy Policy Act of 1992 included a provision which treated biomass facilities and facilities that produce synthetic fuels from coal as being placed in service before January 1, 1993, if such facility was placed in service before January 1, 1997, pursuant to a binding written contract in effect before January 1, 1996. The 1992 act also extended the production-credit sunset date to 2008.

Current Law

Under section 29 of the tax code, certain fuels produced from nonconventional sources are eligible for a production credit equal to $3 (generally adjusted for inflation) per barrel or Btu oil barrel equivalent[2]. (For calendar year 1993, the credit is $5.76 per barrel-of-oil equivalent of qualified fuels.) Qualified fuels must be produced domestically from a well drilled before January 1, 1993; or from a facility that produces gas from biomass or that produces liquid, gaseous or solid synthetic fuels from coal (including lignite) and that is placed in service before January 1, 1997, pursuant to a written binding contract in effect before January 1, 1996.[3] The production credit is available for qualified fuels from a well sold to unrelated persons before January 1, 2003 and from a facility sold to unrelated persons before January 1, 2008.

Qualified fuels include (1) oil produced from shale and tar sands, (2) gas produced from geopressured brine, Devonian shale, coal seams, a tight formation, or biomass (i.e., any organic material other than oil, natural gas or coal (or any product thereof)), and (3) liquid, gaseous or solid synthetic fuels produced from coal (including lignite), including such fuels when used as feedstocks.

Administration's Recommendation

The Administration opposes any general extension of the placed-in-service date or the production-credit sunset date for facilities that produce gas from biomass or that produce liquid, gaseous or solid synthetic fuels from coal.

When Congress enacted the nonconventional fuels production credit in 1980, an objective was to support the development of new alternative technologies to recover oil and gas.[4] By increasing the profitability of these projects, the credit encourages investment in projects that might not have been undertaken without the tax incentive. Another objective of the credit was to encourage industries to develop alternative energy

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[2]A barrel-of-oil equivalent generally means that amount of the qualifying fuel which has a 5.8 million Btu content.

[3]In the case of a facility that produces coke or coke gas, however, this provision applies only if the original use of the facility commences with the taxpayer.

[4]Senate Report No. 96-394, 96th Congress, 1st Session, p. 87.

sources that would be competitive with conventional fuels.[5] The credit was intended to apply only for a limited period of time, however, after which Congress expected "no special incentive will be needed" because the affected industries would have matured and become competitive without government assistance over the life of the credit.[6] The 1992 extension for biomass and coal facilities was intended to be a transition rule for taxpayers with facilities that were soon to be placed in service. This transition period is now almost over and no extension is warranted.

7. Transportation Fuels Excise Tax Exemption for Fuels Used in Commercial Aviation

Background

The Omnibus Budget Reconciliation Act of 1993 (OBRA 1993) generally provided for a 4.3 cents per gallon fuels excise tax on all transportation fuels, with the exception of fuel for commercial aviation, effective October 1, 1993. Gasoline and jet fuel used in commercial aviation is subject to the tax beginning on October 1, 1995.

Current Law

OBRA 1993 imposed a permanent excise tax of 4.3 cents per gallon on: (1) all transportation fuels currently subject to the Leaking Underground Storage Tank Trust Fund ("LUST") excise tax, except for jet fuels used in commercial aviation, (2) liquefied petroleum gases currently taxable as special fuels, (3) diesel fuel used in noncommercial motorboats, and (4) compressed natural gas (CNG) used in highway motor vehicles or motorboats (at 48.54 cents per mcf). Taxable fuels include motor fuels (gasoline, diesel fuel and special motor fuels) used for highway transportation or in motorboats; gasoline used in aviation; gasoline used in off-highway non-business uses (e.g., small engines and recreational trail uses); diesel fuel used in trains; and fuels used in inland waterways transportation. Most fuel uses that are exempt from the LUST tax are exempt from this tax. OBRA 1993 provided a temporary exemption from the 4.3 cents per gallon fuels tax for gasoline and jet fuels used in commercial aviation prior to October 1, 1995.

The provision was effective on October 1, 1993 (with appropriate floor stocks taxes being imposed on that date). In addition, gasoline and jet fuel used in commercial aviation was

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[5]Ibid.

[6]Ibid.

subject to the tax beginning on October 1, 1995 (with appropriate floor stocks taxes being imposed on that date).

Revenues from this transportation fuels tax are deposited in the General Fund of the Treasury. This tax is separate from, and in addition to, any user-based excise taxes imposed on the same fuels to fund the Highway Trust Fund, the Airport and Airway Trust Fund, the Leaking Underground Storage Tank Trust Fund, the Inland Waterways Trust Fund, the Aquatic Resources Trust Fund, or the National Recreational Trails Trust Fund.

Administration's Recommendation

The Administration opposes any delay of the effective date of the 4.3 cents per gallon excise tax on fuel used in commercial aviation. No legislative action is required for this tax to go into effect.

When Congress enacted the 4.3 cents per gallon excise tax on fuels used in transportation, the effective date of the tax with respect to commercial aviation fuel was delayed from October 1, 1993, to October 1, 1995, because of concerns that the commercial airline industry generally was experiencing losses. The date certain for making the provision applicable to commercial aviation indicates that there was no intention that commercial aviation should be permanently exempted from the generally applicable excise tax on transportation fuels dedicated to the General Fund and used for deficit reduction.

An excise tax of 4.3 cents a gallon on commercial aviation fuel will not significantly affect the economic condition of the airline industry. This tax rate is well within the range over which jet fuel prices have fluctuated in recent years. During 1993 and 1994 average monthly jet fuel prices ranged from 50.7 to 61.3 cents per gallon. Moreover, we expect that airlines will pass a portion of these taxes on to passengers and shippers in the form of higher fares and rates.

The revenues and profits of the airline industry have recovered in 1993 and 1994 from recession lows. The Federal Aviation Administration reports that in fiscal year 1994, U.S. commercial airlines had operating profits of $2.6 billion and net profits of $1.2 billion. Passenger enplanements were up 8.2 percent over the prior year and revenue passenger miles up 5.5 percent. The FAA forecasts domestic enplanements to grow at an average rate of 5.8 percent per year over the 1995-97 period and at a rate of 4 percent per year over the next 12 years. International enplanements for U.S. carriers are expected to grow at a 5.8 percent annual rate over the next 12 years.

A tax on jet fuel will not affect the competitiveness of the U.S. carriers, because the tax will apply to foreign carriers

operating in the U.S. and will not apply to U.S. carriers (or foreign carriers) in their international operations.

8. Allocation of Research Expenditures

Background

U.S. persons are taxed on their worldwide income, i.e., their taxable income from both U.S. and foreign sources. To prevent double taxation of foreign-source income that may also be subject to foreign income taxes, U.S. persons may credit foreign income taxes paid against their U.S. tax liability.

The foreign tax credit is limited to the taxpayer's U.S. tax liability on its foreign-source income. Without this limitation, the U.S. effectively would subsidize higher tax rates of foreign jurisdictions by reducing a taxpayer's tax liability with respect to U.S.-source income to compensate for higher taxes imposed by foreign jurisdictions on foreign-source income. A taxpayer's foreign tax credit limitation (i.e., the ability to use its foreign tax credits) increases with the level of its foreign source income.

Consequently, a taxpayer with excess foreign tax credits (creditable foreign taxes in excess of its foreign tax credit limitation) has an obvious incentive to characterize as much income as possible as foreign source and to characterize as many deductions as possible as domestic source. In order to preserve the integrity of the foreign tax credit limitation so that foreign-source income is not taxed twice and foreign taxes do not offset the U.S. tax on U.S.-source income, it is important to accurately measure taxpayers' foreign-source income. This requires both an accurate measurement of a taxpayer's foreign source gross income, and of the deductions that are properly associated with that income.

Sections 861 and 862 provide rules for determining whether income and deductions are from U.S. or foreign sources. Prior to 1977, there were either no final regulations interpreting the expense allocation rules of sections 861 and 862, or regulations that simply restated the statutory rule with little elaboration. In 1977, Treasury issued final regulations governing the sourcing of expenses and other deductions as Treas. Reg. §1.861-8.

The 1977 regulations require research and development (R&D) expenses to be allocated among two-digit Standard Industrial Classification (SIC) code categories. R&D expenses associated with each such category are separately apportioned. R&D expenses that are incurred solely to meet the legal requirements of a particular jurisdiction and that cannot reasonably be expected to generate income (beyond *de minimis* amounts) outside that jurisdiction are allocated directly to gross income from the

geographic source that includes that jurisdiction. The remaining R&D expense is apportioned under *either* the sales method or the gross income method.

Under the sales method, thirty percent of the R&D deduction is exclusively apportioned to income arising from the geographic location where more than 50 percent of the taxpayer's R&D activities are performed. The remaining 70 percent is apportioned between U.S. and foreign source income on the basis of relative amounts of domestic and foreign- source gross sales receipts. A "look through rule" treats sales of certain controlled parties, such as foreign subsidiaries, and uncontrolled licensees as sales of the taxpayer for purposes of determining domestic and foreign gross sales receipts.

As an alternative to the sales method, a taxpayer may apportion R&D expenses based on the relative amounts of gross income from U.S. and foreign sources. Under this method, however, an exclusive allocation based on the place of performance is not permitted. As a further limitation, the portion of the R&D expenses apportioned to U.S.- and foreign-source income cannot be less than 50 percent of the amount that would be apportioned to U.S.- and foreign-source income under the sales method.

The 1977 regulations have been the subject of ten temporary modifications since 1981. A chronology of these modifications follows:

The Economic Recovery Tax Act of 1981 (ERTA) directed the Treasury to study the impact of the 1977 regulations on U.S.-based R&D and on the availability of the foreign tax credit. ERTA also suspended application of the 1977 regulations to U.S.-based R&D expenses for taxpayers' first two years beginning after August 13, 1981. During this period, 100 percent of U.S.-based R&D expenses were apportioned to U.S. source income. Expenses for foreign-based R&D were apportioned between U.S. and foreign source income under the rules of the 1977 regulations.

In 1983, Treasury published a report entitled "The Impact of the Section 1.861-8 Regulation on U.S. Research and Development." This Report described the 1977 regulations as an objective attempt to satisfy the statutory requirement that R&D be properly allocated and apportioned to domestic and foreign source income and described the ERTA regime as an incentive. The Report concluded that, compared to the 1977 regulations, the ERTA regime reduced U.S. tax liabilities of affected taxpayers by $100 to $240 million in 1982. The Report also noted that the ERTA regime had different effects on different corporations, but that the additional tax liability avoided in 1982 would (if paid) have reduced domestic R&D spending in that year by between $40 million

and $260 million. On the basis of these findings, the Report recommended a two-year extension of the ERTA regime.

The Deficit Reduction Act of 1984 extended the ERTA regime for an additional two-year period (the first two taxable years beginning after August 13, 1983).

The Consolidated Omnibus Budget Reconciliation Act of 1985 extended the ERTA regime for an additional one-year period (the first taxable year beginning after August 13, 1985).

The Tax Reform Act of 1986 suspended the 1977 regulations for one year (the first taxable year beginning after August 1, 1986) as it applied to U.S.-based R&D. During this one-year suspension, 50 percent of U.S.-based R&D expenses were exclusively apportioned to U.S. source income (a reduction from the 100 percent rule of ERTA). This 50 percent exclusive apportionment was available to taxpayers electing the gross income method, as well as the sales method of apportionment. The taxpayer's remaining R&D expense was apportioned under the 1977 regulations, except that no limitation was imposed on the use of the gross income method of apportionment with respect to the remaining U.S.-based R&D expenses.

The Technical and Miscellaneous Revenue Act of 1988 suspended the R&D regulations (which had been in effect during 1987) for a four-month period (the first four months of the first taxable year beginning after August 1, 1987), during which time 64 percent of U.S.-based R&D expenses were apportioned directly to U.S. source income and 64 percent of foreign-based R&D expenses were apportioned directly to foreign source income. This rule was codified in section 864(f). The taxpayer's remaining R&D expense was apportioned under the rules of the 1977 regulations except that, for taxpayers who elected the gross income method of apportionment, the amount apportioned to foreign source income was required to be at least 30 percent of the amount that would have been apportioned to foreign source income under the sales method. For the remaining eight months of that taxable year and the following year, the 1977 regulations were in effect.

The Omnibus Budget Reconciliation Act of 1989 reinstated Code section 864(f) for the first nine months of taxpayers' first taxable year beginning after August 1, 1989.

The Omnibus Budget Reconciliation Act of 1990 reinstated Code section 864(f) for a fifteen-month period (the last three months of the first taxable year beginning after August 1, 1989 and the first taxable year beginning after August 1, 1990).

The Tax Extension Act of 1991 extended Code section 864(f) for the first six months of the first taxable year beginning after August 1, 1991.

In 1992, Treasury issued Revenue Procedure 92-56, 92-2 C.B. 409, which administratively reinstated the provisions of Code section 864(f) for the last six months of a taxpayer's first taxable year beginning after August 1, 1991, and during the immediately succeeding taxable year.

The Omnibus Budget Reconciliation Act of 1993 (OBRA 1993) extended the provisions of Code section 864(f) for taxpayers' first taxable year (beginning on or before August 1, 1994) following the taxpayer's last taxable year to which Rev. Proc. 92-56 applies or would have applied had the taxpayer elected the benefits of that Revenue Procedure. The 1993 Act also reduced the exclusive allocation percentage from 64 percent to 50 percent. Therefore, for calendar-year taxpayers, the OBRA 1993 extension expired on December 31, 1994.

Current Law

Prior to its expiration, section 864(f) provided that fifty percent of research and development expenses (other than amounts incurred to meet certain legal requirements, and thus allocable to one geographical source) were exclusively apportioned to income sourced in the place of performance of the research. The remaining research and development expenses were apportioned on the basis of either sales or gross income, but subject to the condition that if the gross income based apportionment was used, the amount apportioned to foreign source income could be no less than 30 percent of the amount that would have been apportioned to foreign source income had the sales method been used.

Administration's Recommendation

As stated in the President's fiscal year 1996 budget, the Administration supports the revenue-neutral extension of section 864(f).

In Revenue Procedure 92-56, Treasury stated that it was undertaking a review of Treas. Reg. §1.861-8(e)(3) and further stated that, if necessary, it would propose appropriate amendments to that regulation. This Revenue Procedure also stated that the Treasury and the IRS were undertaking a review of the 1977 R&D allocation regulations. Treasury contemplates proposing new regulations in the near future that are likely to be more favorable to taxpayers than the 1977 regulations.

This concludes my prepared remarks. I would be pleased to respond to any questions that you may have at this time.

Receipts Effect of Permanent Extension of Expiring Provisions 1/

	Expiration Date	Fiscal Years 1996	1997	1998	1999	2000	1995-2000
				($'s in billions)			
Permanent Extension							
Exclusion for employer provided educational assistance 2/	12/31/94	-0.835	-0.561	-0.597	-0.627	-0.657	-3.277
Research tax credit	6/30/95	-1.108	-1.352	-1.647	-1.867	-2.048	-8.022
Research and experimentation (R&E) allocation rules 3/	8/1/94	-0.991	-0.700	-0.735	-0.771	-0.810	-4.007
Orphan drug tax credit 2/	12/31/94	-0.042	-0.034	-0.038	-0.043	-0.048	-0.205
Full fair market value deduction for gifts of qualified appreciated stock 2/	12/31/94	-0.076	-0.060	-0.065	-0.070	-0.076	-0.347
Targeted jobs tax credit 2/ 4/	12/31/94	-0.262	-0.285	-0.361	-0.449	-0.528	-1.885
Other extensions supported by Administration:							
Oil spill liability tax 2/ 5/	12/31/94	0.373	0.220	0.222	0.223	0.224	1.262
Generalized system of preferences (GSP) 2/	7/31/95	-0.602	-0.489	-0.461	-0.428	-0.431	-2.411
Environmental tax on corporate taxable income 5/	12/31/95	0.307	0.520	0.530	0.536	0.540	2.433
Other expiring provisions to be considered at the hearing:							
Nonconventional fuels production credit 6/	12/31/96	0.000	-0.020	-0.110	-0.250	-0.725	-1.105
Airline fuels excise tax exemption	10/1/95	-0.379	-0.406	-0.422	-0.431	-0.437	-2.075

Department of the Treasury
Office of Tax Analysis

1/ Actual timing of receipts effect will be determined by date of enactment. Five-year totals will generally not be affected.
2/ Assumes retroactive extension with enactment date of 10/1/95.
3/ Assumes extension for taxable years beginning after 8/1/94.
4/ Does not take into account possible program modifications.
5/ Assumes statutory caps are adjusted so as not to be binding.
6/ Credit is available for facilities placed in service before 1/1/97, pursuant to a binding contract in effect before 1/1/96.

Chairman JOHNSON. I appreciate that, because there will be some questions.

Mr. Ross, please.

STATEMENT OF DOUGLAS ROSS, ASSISTANT SECRETARY FOR EMPLOYMENT AND TRAINING, U.S. DEPARTMENT OF LABOR

Mr. ROSS. Thank you. Good morning, Madam Chairman and Members of the Committee, I will briefly summarize my testimony and then submit the full written text for the record.

As you know, the administration did not seek an extension of TJTC, the Targeted Job(s) Tax Credit Program, in its most recent form. We concluded that TJTC did not deliver on its goals. Let me emphasize, however, that that does not reflect an abandonment of the goal of TJTC. In fact, we believe that improving the job prospects of the least advantaged is more important than ever. We have seen a steady decline in the economic prospects of less advantaged workers since the TJTC was enacted in 1978.

While finding jobs for the disadvantaged has always been a challenge, increasingly the challenge is job quality. In 1992, for example, more than three-quarters of all young workers between the ages of 18 and 24 had annual earnings that were too low to support a family above the poverty level. The administration has taken a number of concrete steps to try and address that problem.

The President's Middle-Class Bill of Rights provides individual skill grants to disadvantaged workers so that they can get the skills they need to earn better living, and we are fighting to preserve and, in some cases, expand programs that have a track record of effectively serving disadvantaged young people—the summer jobs program, the Job Corps Program, and youth training efforts modeled after programs like the San Jose Center for Employment and Training. As you know, our welfare proposal also preserves funding for training to help welfare recipients make the transition to jobs.

Despite the growing problem of low-income youth and this administration's commitment to an activist role in solving it, we do not support reauthorizing the TJTC in its present form. We have not come to this conclusion lightly. It is based on literally a dozen studies, and we think if there is going to be an effort to create a new, more effective credit, it has to deal with three very serious problems of the old TJTC.

First, there was great evidence that the great majority of the tax credits under the old program were windfalls to employers who would have hired the disadvantaged target group anyway. While it is true that TJTC eligible groups do suffer from high rates of unemployment, a large fraction of them actually work, mostly in the kinds of low-wage jobs subsidized by TJTC.

Unless employers claiming TJTC subsidies hire workers that either have more significant barriers to productivity or they pay them more or they retain them longer or they invest more in their development than other employers in the normal course of business, participating firms collect a benefit with no corresponding gain to the public. Unless we change behavior, we are getting nothing for our money. In tight times like this, you cannot spend money where you get nothing for it.

Second, TJTC jobs are almost always low wage and low skill, and the typical worker does not remain at these jobs long. According to the Office of the Inspector General, the median TJTC certified worker receives less than $4,000 in total wages before losing the job or leaving their job, and 50 percent do not stay longer than 6 months, which is something you get without the credit.

Third, TJTC participation appears to have little or no effect on earning power or long-term career advancement. In other words, when you compare those who are hired with it and those who are hired without it, the earnings are roughly the same and their long-term unemployment rates are about the same. It does not have any effect on what happens to them over the long run.

Besides these formal studies, there is some pretty distressing anecdotal evidence that you need to take into consideration, if Congress is going to proceed in this area. In some cases, we found Wall Street investment banks have collected the TJTC for young new hires or for summer interns. These were not actually disadvantaged youth, but were college students or recent graduates who lived off savings and scholarships while in school, and thus qualified as "disadvantaged."

For instance, in a number of cases, recent graduates of the Harvard Business School and Wharton School of Business qualified for the TJTC. That is not what this is about. In some—I thought—pretty impressive testimony in front of Congress last year by Charlene Jackson, who is Deputy Administrator of the Texas Employment Commission, and gives some feel for what we are seeing out in the field under the old program. She detailed cases where a consulting group submitted large numbers of falsified information claiming that young people qualified as a disadvantaged family of one, when in fact they were still being supported by middle-class parents.

If the Congress decides to pursue a new tax credit program for the disadvantaged, it should structure the program to avoid some of these problems that plague TJTC.

Let me talk very briefly about four principles that we would recommend as an administration that Congress look at, if they are going to create a new credit.

First, we have got to limit the potential for abuses of the program and target it to people who really need it. To do this, we think eligibility should be based on some clear and easily documentable evidence of economic advantage.

Examples could be current or recent recipients of means tested welfare program, ex-convicts or youths enrolled in State or Federal education or job training programs for the disadvantaged or disabled workers in voc rehab programs. The key is, there is an existing agency that knows whether this is a person who qualifies, who at virtually no extra cost can certify it and say this is someone on welfare. You do not need to go through some long and complex and subject-to-fraud process to find out who they really are.

Second, we have got to deal with this employer windfall problem. All too often, employers have screened for TJTC eligibility and certified their workers only after hiring them. A promising reform in this area would be to require eligible workers to gain tax credit eligibility prior to hiring. In other words, we have got to know who

is eligible first, then if you hire them, it is a conscious act. If you just hire everybody and, after the fact, see if any of them qualify, we are not getting much for our money, and maybe we are getting nothing for our money.

Third, we have got to improve the incentive to provide longer lasting jobs under the TJTC. As I said, half of all hires remained on the job for less than 6 months. A reformed tax credit program should induce employers to provide jobs that last. An employer should receive, therefore, greater reward from the credit when they manage to retain their employees for longer than a couple of months.

Finally, we have got to improve training incentives. The TJTC does not provide enough incentive to build worker skills and thus improve their long-term outcomes. Given the importance of skills in shaping employment prospects, there is a strong case for injecting a learning component into a reformed TJTC.

Madam Chairman, we offer these principles as the starting point and we offer possible discussion between the administration and Congress, should Congress wish to pursue the design of the new tax credit. The details of the approaches discussed here have not been fixed, nor have we really done any cost estimates.

In summary, as my colleague from Treasury stated, the administration would be open to working with Congress in designing a reformed tax credit program, provided that the resources to finance a reformed credit are a supplement to existing proven investments in the disadvantaged, not a substitute.

Thank you very much.

[The prepared statement follows:]

TESTIMONY OF DOUGLAS ROSS
ASSISTANT SECRETARY OF LABOR
FOR EMPLOYMENT AND TRAINING
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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Good morning, Madam Chairman and Members of the Subcommittee. I am pleased to have the opportunity to testify before you on the Targeted Jobs Tax Credit.

The Targeted Jobs Tax Credit (TJTC) was enacted in 1978 to improve the private sector employment prospects of disadvantaged individuals. The credit expired at the end of calendar year 1994.

As you know, the Administration did not seek an extension of TJTC in its most recent form. We concluded that TJTC did not deliver on its goals, and either needed to be reformed or discarded.

Let me emphasize, though, that we are not abandoning the goal of TJTC. Indeed, we believe improving the job prospects of the least advantaged is more important than ever.

Unfortunately, we have seen a steady decline in the economic prospects of less-advantaged workers since the TJTC was enacted in 1978. The groups targeted by the TJTC are precisely those who have suffered most from this decline. Over 11 percent of the American population received welfare payments in 1993 -- a new record, up from less than 8 percent in 1978. Unemployment rates among young, out-of-school high school graduates have increased from 8.8 percent in 1978 to 13.3 percent in 1993 -- and the situation is even worse for dropouts.

The fundamental problem has as much or more to do with job quality as with job quantity. When disadvantaged workers find jobs, their wages are typically very low, and have been dropping. The median income (in constant dollars) of families led by people aged 24 or under has declined by over one-third since 1978, and in 1992 was only $15,700 annually. In 1992, some 76% of young workers 18 to 24 had annual earnings too low to support a family above poverty. Most economists believe that the low wages and low job quality available to disadvantaged youth are a major reason why so many have dropped out of the labor force completely, and why some turn to crime.

The Administration has taken concrete steps to address these problems. Our proposed Middle-Class Bill of Rights provides individual grants to disadvantaged workers to gain needed new skills. We are fighting to preserve and in some cases to expand programs of demonstrated effectiveness in serving disadvantaged youth -- the Summer Jobs program, the Job Corps program, and youth training efforts modelled after the San Jose Center for Employment and Training. And we favor welfare reform that preserves substantial substantial funding for training and other services to help welfare recipients make the transition to private sector jobs.

However, we must take a critical look at the TJTC. We remain open to the possibility that an employment tax credit could be an important part of an effective strategy to improve the job prospects of the disadvantaged. However, the evidence strongly suggests that the TJTC has failed to achieve that goal.

Since 1978 when TJTC was first enacted, Congress has repeatedly passed extensions of the program, including retroactive extensions after the credit had expired. We do not believe that such an extension should be enacted unless the

Congress is able to provide meaningful changes to the program that hold out the strong promise of increased effectiveness. Nor do we believe that a new tax credit program should be instituted unless it includes steps to address the problems that plagued the TJTC. We would be open to working with Congress in designing a reformed tax credit program, provided that the resources to finance a reformed credit are a supplement to existing investments in the disadvantaged, not a substitute.

Let me briefly describe the program and the evidence we have regarding its effectiveness. TJTC was a nonrefundable tax credit available to employers who hire: the economically disadvantaged, including youth aged 18-22; cooperative education students 16-19 years old; ex-offenders; Vietnam-era veterans; individuals receiving general assistance, Supplemental Security Income, or Aid to Families with Dependent Children; or vocational rehabilitation referrals. Economically disadvantaged summer employees aged 16-17 were also included. The program allowed for a tax credit of 40 percent of any portion of the first $6,000 earned by a certified worker within a year of the hire, provided the employee worked at least 120 hours or 90 days. Lower limits (in dollars, credit rate, and hours) apply to summer youth employees.

Administration of the TJTC has been a joint responsibility of the Treasury Department's Internal Revenue Service and the Federal-State Employment Service system. The IRS has been responsible for administering the tax-related aspects of the program, while the State Employment Service Agencies, funded by the Department of Labor's Employment and Training Administration, has been responsible for documenting worker eligibility, vouchering and issuing certifications to employers.

Including the two studies recently issued by the OIG, there have been some twelve studies of the results of the TJTC program completed over the past 15 years. Numerous other publications on the TJTC have reviewed the findings or data of these studies. In general, the research indicates the following:

1. There is evidence that the great majority of the tax credits are windfalls to employers who would have hired the disadvantaged target group members anyway. While TJTC-eligible groups do suffer from high rates of unemployment, a large fraction of the eligible population does work--mostly in the kinds of high-turnover, low-skill jobs subsidized by TJTC. Unless employers claiming TJTC subsidies hire workers with more significant barriers to productivity, pay them more, retain them longer, or invest more in their development than other employers, participating firms collect a benefit with no corresponding gain to the public. Existing studies estimate that from 70 percent to 90 percent of TJTC certifications go to individuals who would have found jobs even in the absence of the credit. The most recent Inspector General's report projects that employers would have hired 92 percent of the individuals even if the credit had not been available.

2. TJTC jobs are almost always low-wage and low-skill, and the typical worker does not remain at these jobs long. Nationally, the OIG found that most TJTC jobs were low-skilled and entry-level, with an average hourly wage of roughly $5.15 per hour. Our own administrative data confirm these low wages. What is even more important is that TJTC jobs are typically of very short duration. The OIG found that the median TJTC-certified worker remains on the job for only about 6 months, and other research has confirmed this finding. The combination of low wages and low tenure adds up to low total earnings. According to the OIG, the median TJTC-certified worker receives about $4,000 in total wages before losing or leaving their job.

3. TJTC participation appears to have little or no effect on

earning power or long-term career advancement. A 1991 GAO report did not find substantial differences in earnings resulting from TJTC work experience when compared with work experience of other TJTC-eligible workers who were not certified under the program. According to our own analysis of Census data, there is little difference between the hourly wages of TJTC eligibles who are certified under the program and those that are not.

Some claim that the work experience gained in jobs subsidized by the credit pays off in better job prospects for the future, counterbalancing the low quality of the immediate jobs. But the evidence does not support this. A 1988 report found that even five years after participation in TJTC, the average annual earnings of minority male youth who had been certified under the program were only about $7,000 per year (1993 dollars), and those of female youth were even less. Also, the Labor Department OIG determined that 35% of TJTC participants were unemployed when they were contacted about a year and a half after entering their TJTC jobs. This compares to 38% in the year before getting the job. Again, there is little evidence of improvement due to TJTC.

Besides the evidence from formal studies, there is also anecdotal evidence on the actual workings of the TJTC in the field. Based on discussions with field personnel from the state employment security agencies (SESAs) who actually run this program, we understand that abuse of the TJTC was frequent. Sometimes abuses were due to outright fraud, and sometimes they resulted from loopholes in the program rules and the difficulty of enforcing eligibility standards. However, we believe that all these abuses raise disturbing questions about the effectiveness of the program.

To take one example, in some cases Wall Street investment banks have collected the TJTC for young new hires or for summer interns. These youth were not actually disadvantaged, but were college students or recent graduates who lived off savings and scholarships while in school, and thus qualified as "disadvantaged". In fact, some of them were recent graduates of Harvard University and Columbia University.

There have also been cases of firms which mass-produce TJTC applications. After they are hired, all youth employees are interviewed. Those who report a low income over the past 6 months are asked to fill out a TJTC application which identifies them as a family of one (i.e. not dependent on their parents). These applications are then submitted en masse to SESAs, with the expectation that they will be rubber-stamped. Upon examination, one SESA has found that the great majority of these applications raise questions as to whether the applicant is actually a "family of one". Upon further review, these middle class students are not disadvantaged -- some are graduates of expensive private universities. Often applicants and their families express amazement, when interviewed, that anyone could think them to be economically disadvantaged.

The testimony of Charlean Jackson, the Deputy Administrator of the Texas Employment Commmission, in front of Congress last year gives some feel for the extent to which this program is abused in the field. Ms. Jackson testified that "The TJTC program is one that invites fraud." She detailed cases where consulting groups submitted large amounts of falsified information claiming that young people qualified as a disadvantaged "family of one", when in fact they were still being supported by their middle-class parents.

She felt that the issue was both that the program rules were difficult to enforce, especially when mail-in certification was used, and that resources to enforce it were limited. Ms. Jackson testified that more cases of abuse could have been uncovered if Texas had the financial resources to perform additional audits.

Ms. Jackson believed TJTC abuses were so frequent that Congress should not extend the program unless a serious attempt to address these problems was made.

If the Congress pursues a new tax credit program for the disadvantaged, it should structure the program to avoid some of the problems that plagued the TJTC. I believe that a thoughtfully designed tax credit program could be an effective tool for improving the employment prospects of disadvantaged Americans. Specifically, I believe the following four principles should apply:

1. Limit the potential for abuse of the program, and target it on the truly disadvantaged. Eligibility for the credit should be based on clear and easily understandable signal of economic disadvantage. Possible examples could be current or recent recipients of means-tested welfare programs, ex-convicts, or disabled workers in vocational rehabilitation programs.

Although this step would limit the eligible population, it would also limit abuses of the program, and focus it on the truly disadvantaged. For example, it is much easier to determine if an individual has been a recent welfare recipient than it is to determine if they are truly economically disadvantaged. In the former case, only a certification from a welfare office is needed. In the latter case, extensive information is neccessary on family income, location of residence, parental support, etc.

In the case of youth, determination of whether an individual is actually "economically disadvantaged" becomes especially complex. Most young people -- whether disadvantaged or not -- go through a period of low earnings at some point when they go to college or get their first jobs. During this period it is difficult to determine whether the youth is still receiving parental support, and if so, how much. The examples given above of college students receiving the credit show the way in which the "economically disadvantaged youth" eligibility group in the TJTC program can be abused.

2. Reduce employer windfall. All too often, employers have screened for TJTC eligibility and certified their workers only after hiring them. A promising reform in this area would be to require eligible workers to gain tax credit eligibility prior to hiring. As discussed above, a number of consulting companies appear to have made it a standard practice to submit all new youth employees of a company for TJTC certification, sometimes using fraudulent means to do so. This practice ensures that the credit will not impact hiring. Any future jobs-related credit should require certification for credit eligibility prior to hiring.

3. Improve the incentive to provide long-lasting jobs under the TJTC. I have already described the low quality jobs that have been subsidized by the TJTC, in which half of all hires remained on the job for less than 6 months. Recent TJTC program rules -- which offered a substantial subsidy for only the first few months of employment -- may even have provided some incentive for rapid employee turnover in order to maximize the credit amount. The program paid employers to provide the same kinds of low-quality jobs that many eligible workers drift in and out of on their own, without subsidies. And it gave too little incentive to hire and retain workers for the long term. Research has shown that job retention -- not just initial hiring -- is one of the greatest problems for low-skill workers.

A reformed tax credit program should induce employers to provide jobs that last. Employers should receive a greater reward from the credit when they manage to retain their employees for longer than a few months. One way of doing this would be to "backload" the credit, perhaps by providing a limited credit

amount for the first few thousand dollars in wages, and then a higher credit for the next several thousand. This would reward employers who retained their workers. Another way to address this problem would be to allow the credit only for employers who retained their workers for some significant period.

4. Improve training incentives. The TJTC does not provide enough incentive to build worker skills and thus improve their long-term outcomes. Given the importance of skills in shaping employment prospects, there is a strong case for injecting a learning component into a reformed TJTC. One way to do this would be by making the work-based learning slots created in conjunction with school-to-work programs eligible for TJTC subsidies. Less ambitiously, legislative and administrative steps could be taken to make participation in TJTC more accessible for low-income school-to-work participants. Besides school-to-work, there is also the possibility of extending the TJTC credit to formal training expenses for TJTC-eligible workers. However, it could be difficult to define which training expenses would qualify.

We are prepared to discuss the design of a new tax credit program with Congress, should it wish to pursue this option. We have presented these principles here as a starting point for discussion. The details of the approaches discussed here have not been fixed, nor have we done formal analysis of the costs and benefits. Also, we have concerns that some of these approaches could have negative side effects such as increased administrative complexity which would diminish their overall effectiveness. However, we do believe that these approaches could improve the TJTC program. Of course, the Administration's position on specific proposals will depend on the overall package, and on what offset is used to finance the reauthorization.

Madam Chairman, this concludes my prepared statement. At this time I would be pleased to answer any questions that you or other Members of the Subcommittee may have.

Chairman JOHNSON. Thank you, Mr. Ross, for your excellent testimony.

Mr. Murphy.

STATEMENT OF PATRICK V. MURPHY, ACTING ASSISTANT SECRETARY FOR AVIATION AND INTERNATIONAL AFFAIRS, U.S. DEPARTMENT OF TRANSPORTATION

Mr. MURPHY. Thank you, Madam Chairman.

On behalf of the Department of Transportation, I would like to thank you for this opportunity to testify today. I would like to summarize my testimony and submit the full testimony for the record.

Two years ago, Congress imposed a 4.3-cents-per-gallon excise tax on transportation fuels, effective October 1, 1993, but temporarily exempted the airlines from paying the tax as it would have applied to aviation fuel. That statutory exemption expires September 30, 1995. Given the improving health of the airline industry and the need to reduce the Federal budget deficit, the administration believes that the exemption should not be extended. This action is also appropriate, given that the other transportation industries have paid their full share of this tax for the past 2 years.

The airlines are today in far better position than they were 2 years ago to absorb the impact of the fuel tax. At the time Congress granted the exemption, the airline industry was undergoing the worst financial crisis in its history.

In 1992, the U.S. aviation industry suffered its worst year ever, with total operating losses of $2.3 billion and net losses of $4.6 billion. The airlines at that time had accumulated over $10 billion in net losses. All major carriers except Southwest had suffered heavy losses. Several airlines, including Eastern and Pan American, had ceased operations and were liquidated during this period, and three more major airlines had filed for bankruptcy protection.

Today, the picture is significantly different. Most airlines have experienced major improvements in their financial condition. As the economy has recovered from recession, so has airline traffic. The airlines have also engaged in a major restructuring of their operations, increased efficiency, cut excess capacity, reduced unit operating costs, and enhancing their competitive strength.

In addition, the three major airlines that had been under bankruptcy protection 2 years ago have since emerged from chapter 11 proceedings. As a result, the major airlines' operating profits grew to $2.4 billion in 1994, and their net loss declined to $603 million. These trends are continuing into 1995. The majors' first-quarter operating profit increased from $85 million in 1994 to $485 million in 1995. Since the first-quarter results are normally low, owing to the extreme seasonality of airline traffic, we expect the airlines to show a strong operating and net profit for 1995.

The FAA now forecasts that the currently robust airline traffic growth will hold for the next 2 years, and then continue at a healthy 4.2-percent growth rate through 2006. The strong growth in traffic, combined with the airlines' ongoing capacity reductions, should result in higher load factors for the industry. This, in turn, should boost operating profits. In view of these factors, we are now optimistic that the airlines' net income will also continue to improve.

Wall Street analysts appear to share this positive outlook for the airlines. The emerging consensus among airline analysts is that the airline fundamentals have improved and should continue to improve. The positive fundamentals include increased traffic, restrained capacity growth, higher load factors, improving revenue performance, cost containment, and financial restructuring. These are not temporary changes.

As Michael Derchin of NatWest Securities has stated, "These are not the type of changes that affect profitability for a quarter or two, but the type that can enhance the profitability picture for this industry for the rest of the decade."

The airlines' recovery has been driven, in part, by the steady decline in fuel costs in recent years. Airline fuel costs have declined from 78-cents-per-gallon in 1990 to about 53-cents-per-gallon today. In 1990, fuel costs accounted for nearly 17 percent of total operating expenses. Last year, fuel costs were about 10.6 percent of total operating expenses.

In this perspective, the impact of a 4.3-cents-per-gallon fuel tax is now far less onerous than it was 2 years ago. Based on the latest reported data, if the tax were imposed on the 12.6 billion gallons of fuel purchased by the airlines in 1994, airline expenses would be higher by $543 million annually, an increase in operating expenses of only 0.7 percent. Moreover, we anticipate airlines will pass through some portion of the tax to passengers and shippers in the form of higher fares and rates and will adjust capacity to make service adjustments. A further reduction on the impact would result from the manner in which fuel tax expenses are handled by the airlines in calculating their income tax liability.

The 4.3-cents-per-gallon fuel tax was applicable to highway gasoline and diesel fuel, maritime fuels, general aviation and commercial aviation fuel. Only the tax on commercial aviation fuel was deferred for 2 years, the reason being to give airlines time to recover.

We have calculated the relative impact of the deficit reduction portion of the Federal excise fuel tax on railroads and motor carriers. We estimate that for 1994, the impact of deficit reduction on Class I railroads was $221 million and $1.78 billion for motor carriers and their users.

In this context, the case for extending an exemption is very difficult as a matter of fairness. Other transport modes have paid the 4.3-cents-per-gallon fuel tax for almost 2 years. By the time the commercial aviation exemption expires, motor carriers and their users alone will have paid as much as $3.5 billion over 2 years. In view of the airline industry's ongoing recovery, there is no longer any justification for granting the airlines preferential treatment compared to the other modes of transportation.

Thank you.

[The prepared statement follows:]

STATEMENT OF PATRICK V. MURPHY
ACTING ASSISTANT SECRETARY OF TRANSPORTATION
FOR AVIATION AND INTERNATIONAL AFFAIRS
BEFORE THE
HOUSE COMMITTEE ON WAYS AND MEANS
CONCERNING THE FINANCIAL CONDITION OF THE AIRLINE INDUSTRY
MAY 9, 1995

Madame Chairman and Members of the Committee, the Department of Transportation is pleased to have this opportunity to comment on the financial condition of the U.S. airline industry.

Two years ago, the airline industry was in the very earliest stages of recovery from the most severe financial crisis in its history. In 1992, the U.S. aviation industry suffered its worst year ever, with total operating losses of $2.2 billion and net losses of $4.6 billion, and had accumulated over $10 billion in net losses from 1990 through 1992. All major passenger carriers except Southwest Airlines had suffered heavy losses. Several airlines, including Eastern and Pan American--two of America's oldest and largest airlines--had ceased operations and were liquidated during this period, and three more major airlines--America West, Continental, and TWA--had filed for bankruptcy protection under Chapter 11; several more airlines were considered by industry analysts to be on the brink of bankruptcy.

I am pleased to report that today's picture is different. Most airlines have experienced improvements in their financial condition. As the economy has recovered from recession, so has airline traffic. The airlines have also engaged in a major restructuring of their operations. As a result, they have increased efficiency, cut excess capacity, reduced unit operating costs, and enhanced their competitive strength. In addition, the three major airlines that had been under bankruptcy protection two years ago have since emerged from Chapter 11 proceedings.

Historic Financial Results

Since 1985 the airlines have ridden a financial roller coaster. From 1985 through 1989, the major airlines as a group had strong net income in every year but 1986. Over the five-year period, they had cumulative net income of over $3 billion, including $1.6 billion in 1988. By the end of 1989, the major airlines had aggregate net stockholders' equity of nearly $14 billion, and long-term debt of nearly $16 billion. The airlines' debt/equity ratio stood at a fairly healthy 53/47 level.

Beginning in 1990, the airlines suffered three consecutive years of massive losses. In 1990, the major airlines lost over $3.6 billion, due primarily to Iraq's invasion of Kuwait, the subsequent Gulf War, and the consequent increase in fuel prices and decline in international airline traffic. The airlines suffered another $1.8 billion loss in 1991 as the economy slid into recession, and $4.6 billion in 1992 (including over $2 billion in one-time charges to reflect changes in the airlines' accounting of pension liabilities). By the end of 1992, the majors' long-term debt had skyrocketed to over $21 billion, and stockholders' equity had plummeted to about $9.2 billion. The industry's debt/equity ratio had climbed to 70/30.

The industry began its recovery in 1993, when the major airlines earned operating profits of $1.4 billion and net income of $454 million. Six of the nine major passenger airlines were profitable in 1993. (These figures somewhat overstate the industry's improvement, as they include "fresh start" accounting for Continental and TWA with their emergence from bankruptcy in 1993.) Although they posted a small net loss of $121.5 million, the major airlines' operating profits increased to $2.4 billion. Five of the nine major passenger airlines posted operating profits and net profits, as did both major all-cargo airlines.

Although long-term debt continued to increase in 1993, ***to $27 billion, net stockholders' equity began to recover, climbing nearly one-third to $12.3 billion.***

The industry's long-term debt declined in 1994 to $27.3 billion, and stockholders' equity grew another 30 percent to a record high of nearly $16 billion. The majors' debt/equity ratio has improved to 62/38.

The overall industry recovery during the last two years has been driven primarily by the general economic recovery from the 1991-1992 recession. In addition, carriers have been significantly aided by the rapid decline in aviation fuel costs since 1990. Because of instability in the oil markets caused by the Iraqi invasion of Kuwait, the industry's average cost of fuel jumped to nearly 78 cents per gallon in 1990. Fuel prices have declined sharply every year since then, falling to 60 cents in 1993 and to 58 cents during 1994. This steep, rapid decline in jet fuel costs has been a primary factor in the airlines' recovery over the last two years. Finally, most major carriers have restructured their operations to improve efficiency and cut costs, in order to become more competitive not only with each other but with low-cost carriers like Southwest and successful new entrants.

Since January 1992, no fewer than 30 new jet airlines have started up domestic U.S. operations, and we have authorized operations for 12 carriers who have not yet commenced service. At this moment, we have 10 more new entrant applications pending before the Department. These and other low-cost, mid-size airlines have filled a void left by the majors in point-to-point, short-haul and medium-haul city-pair markets with dramatically positive results. The larger carriers have been forced by this development to redouble their cost-cutting efforts. They have reduced service on unprofitable routes, expanded service on underserved routes, retired older, inefficient aircraft, and, in some cases, achieved new collective bargaining agreements that allow a more efficient use of labor. In order to improve the efficiency of their operations, airlines have entered into major domestic and international code-sharing and joint-marketing alliances with other carriers. Many have also restructured their debt and equipment leases to improve earnings and cash flow; others have reappraised their entire route structures and operating philosophies. In addition, management leaders at many airlines have increasingly formed partnerships with labor by encouraging employee ownership, primarily through Employee Stock Option Plans. Employees now hold an outright majority share of United, the nation's largest airline, and own large equity shares of many other airlines, including America West, Continental, Northwest, Southwest, and TWA.

These changes in the airlines' operations constitute the most comprehensive restructuring of the industry at least since the development of hub-and-spoke networks in the early and mid-1980s, and perhaps since passage of the Airline Deregulation Act in 1978.

As a result of this restructuring, most airlines have achieved dramatic improvements in their financial position. Northwest, in particular, has made enormous strides in the past two years. After suffering record losses of $386 million in 1992, it earned $81 million in 1993, and ***a record $430 million last year.*** American, America West, and United, which also suffered from heavy losses in 1992, were all solidly in the black by 1994. Southwest, which was the only profitable passenger carrier in 1992, saw its net earnings increase $180 million last year. And ValuJet, less than 2 years old, enjoyed an astounding 25 percent operating margin last year, with net income of over $20 million. Restructuring has also enabled the three major airlines formerly under Chapter 11 protection to reorganize and escape from bankruptcy. Continental emerged from bankruptcy in April 1993, TWA in November 1993, and America West in August 1994.

At the same time, the airlines' recovery has not been uniform. Despite their large aggregate operating profits, the major carriers posted net losses for 1994 of $121.5 million, and a few carriers remain in a weak financial position. Even the weaker carriers, however, have made significant progress in cutting unit costs, rationalizing their route systems, and increasing efficiency. As airline traffic increases with continued economic growth, the industry's fortunes should improve considerably.

Forecast Operating and Financial Results

The airline industry's financial prospects are critically dependent on continued airline traffic growth, which itself is a function of overall growth in economic output. Gross domestic product (GDP) grew by 3.8 percent in fiscal year 1994. At the same time, airline traffic increased by 5.5 percent, from 483 billion revenue passenger miles (RPMs) in FY 1993 to 510 billion in FY 1994.

OMB forecasts continued GDP growth of 3.1 percent in FY 1995, 2.4 percent in FY 1996, and 2.5 percent in FY 1997-2001. Thereafter, the FAA forecasts continued growth in GDP of 2.5 percent in FY 1997 to 2001, and 2.4 percent from FY 2002 through 2006. (The FAA's long-term forecast is based on a consensus of long-term growth forecasts issued by several economic analysts in the private sector.) Furthermore, the FAA forecasts that the currently robust airline traffic growth rates will continue for the next two years, and then continue at a healthy 4.2 percent through FY 2006. The FAA forecasts airline traffic of 537 billion RPMs in FY 1995, 567 billion in FY 1996, and 869 billion by FY 2006.

Most major airlines have announced plans to control or trim their capacity this year, and to continue pursuing reductions in unit costs. Continued strong growth in airline traffic, therefore, should result in higher load factors for the industry. This, in turn, should boost the airlines' operating profits, even as their real passenger yields (revenue per passenger-mile) continue to fall.

We are now optimistic that the airlines' net income should also continue to grow. Long-term debt should continue the slow decline begun in 1994, and net stockholders' equity should increase sharply.

As over the last two years, however, these benefits may not be spread evenly among the carriers. Airlines with high costs or poor route structures may continue to struggle unless they effect significant corrective steps. Highly leveraged carriers are especially vulnerable to upward pressures on interest rates. Nevertheless, we anticipate that even the weaker carriers should progress toward profitability over the next several years, albeit possibly at a slower rate than the healthier airlines.

Airline industry cost structure

The airline industry is labor-intensive. During 1994, salaries and wages accounted for 24.7 percent of the major airlines' total operating expense, and fringe benefits comprised another 9.6 percent. Total labor costs amounted to 34.3 percent of their operating expense, by far the largest expense item.

Fuel and capital costs were the next largest expense groups. The majors' fuel and oil expense was 11.0 percent of operating expense. Total equipment costs (rentals plus depreciation) were 13.7 percent of operating expense. Passenger traffic commissions are also a major airline expense, amounting to 9.4 percent of operating expense. Altogether, labor, fuel, equipment, and commission costs made up 68.4 percent of total expense in 1994.

The distribution of airline expenses has not been static over time. Fuel and oil made up nearly 23 percent of airline expense in 1985, declining to a low of 13.7 percent in 1988 before climbing again to 16.7 percent in 1990 with the Iraqi invasion of Kuwait and the attendant instability in the oil markets. Since that time, the industry's fuel cost has declined as a share of operating expense to a 10-year low of 11.0 percent in 1994.

Traffic commissions grew rapidly and nearly continuously during the last ten years, from 7.8 percent of expense in 1985 to 10.3 percent in Calendar Year 1993, an increase of one-third, before ***declining to 9.4 percent in fiscal 1994.*** Aircraft rentals have also grown from 3.5 percent in 1985 to ***8.5 percent in FY 1994.***

Labor expenses as a share of total expense have fluctuated a great deal over the last 10 years, falling from a high of 38.6 percent in 1986 to a low of 31.9 percent in 1990. They have since increased to ***34.3 percent in FY 1994.*** Depreciation has shown a

similar trend, declining from 5.5 percent in 1985 to 4.3 percent in 1990, and since then *climbing to 4.9 percent in FY 1994.*

Unit costs have also shifted over time. Total operating expense per available seat-mile (ASM) grew from a low of 7.2 cents in 1986 to a peak of nearly 9.3 cents in 1991. Since that time, total unit cost has declined somewhat *to about 9.2 cents per ASM.* Labor costs, which were 2.7 cents per ASM in 1986, have climbed steadily, reaching *nearly 3.4 cents in FY 1994.* Passenger commissions have also grown continuously and rapidly, from 0.6 cents per ASM in 1986 to nearly 1.1 cents in 1993, an increase of over 72 percent in seven years, before *declining in FY 1994 to 1.0 cents* per ASM. Equipment costs (depreciation, amortization, and rentals) have also increased, *from 0.8 cents per ASM in 1986 to nearly 1.4 cents in FY 1994.* Fuel costs, on the other hand, peaked at 1.6 cents per ASM in 1990, and have since declined *nearly one-third to less than 1.1 cents per ASM.*

By functional grouping, the airlines' largest costs were aircraft operating expense, which accounted for *40.1 percent of total operating expense in fiscal 1994.* (Aircraft operating expense consists of flying operations expense, flight equipment maintenance, and depreciation and amortization on flight equipment.) Other major functional groupings are reservations and sales expense (including commissions), which accounted for *16.6 percent* of total expense, traffic servicing at *10.3 percent*, passenger servicing at *9.4 percent*, and aircraft servicing at *6.2 percent* of operating expense. Together these five groups accounted for *82.6 percent of the airlines' operating expenses in FY 1994.*

Effect of the 4.3 cent jet fuel tax

Two years ago, Congress temporarily exempted the airlines from paying the 4.3 cents-per-gallon excise tax on jet aviation fuel. That statutory exemption expires September 30, 1995. At the time Congress granted the exemption, airlines were undergoing their worst financial crisis in history.

The industry is now in a position to accommodate this tax increase. Therefore, we do not support a further extension of the exemption. As I noted earlier, fuel costs have continued to fall, and now represent only *about 11 percent* of the industry's total operating expense. In absolute terms, fuel is now about *56 cents per gallon*, down from 78 cents in 1990 and 64 cents in 1992. In that perspective, the impact of a 4.3 cent-per-gallon fuel tax is far less onerous. *Based on the latest reported data, if the tax were imposed on the 12.1* billion gallons of jet fuel purchased by the major airlines, the airlines' fuel expense would be higher by *$543 million annually*--an increase over actual fuel expense of *7.9 percent*, but an increase in total operating expense of only *0.7 percent*.

The Department of the Treasury estimates that, for every dollar it gains from the aviation fuel tax, it loses about 25 cents in corporate income tax from the airlines. Thus, a very rough estimate of the net effect of the fuel tax on the airlines would appear to be *about $407 million*, or only about one-half of one percent of operating expense. Moreover, we anticipate that the airlines will pass through some portion of the tax onto passengers and shippers in the form of higher fares and rates. We also expect that the airlines will adjust capacity and make equipment and service adjustments to increase fuel efficiency, thus further reducing the tax's cost burden. Thus, the net impact on the industry would be substantially *less than $407 million*.

In this context, the case for extending an exemption is very difficult as a matter of fairness to other transport modes, which have paid increased excise taxes on fuel during the past two years. The Administration's position, therefore, is that there is no longer a justification for exempting the airlines from paying their fair share of energy taxes beyond the current fiscal year.

Recommendations to enhance airline profitability

Because the airline industry is hyper-sensitive to overall economic conditions, the surest road to the industry's recovery is continued economic growth. As Laura D'Andrea

Tyson, then Chair of the President's Council of Economic Advisors and now Chair of the National Economic Council, wrote last year in introducing the Administration's Initiative to Promote a Strong Competitive Aviation Industry, "A strong economy will be the best medicine for what ails the aerospace complex."

Nevertheless, as Dr. Tyson added, "a strong economy cannot alone cure these industries' ills." There is still a role for government policies to promote the financial health of the aviation industry. Two years ago, at the Administration's behest, Congress established the National Commission to Ensure a Competitive Aviation Industry to investigate the causes of the aviation industry's financial woes, and to recommend measures to speed their recovery. The Commission adopted a list of 61 recommended steps to improve the aviation and aerospace industries' viability.

In January 1994, in response to the Commission's recommendations, the Administration unveiled its Initiative to Promote a Strong Competitive Aviation Industry. The Administration adopted 49 of the Commission's recommendations. As of January 1995, the Department has taken a large number of specific administrative actions to implement these recommendations.

Among the Department's most prominent actions are the introduction of new technology and navigation rules to streamline the FAA's air traffic control, which has already significantly reduced fuel consumption and airport delays for many carriers; accelerated implementation of the Global Positioning System; and a comprehensive examination of the High Density Rule affecting the four slot-controlled airports (Kennedy, LaGuardia, O'Hare, and Washington National), in order to determine the rule's impact on airline competition, fares, and service patterns. In addition, the Department has continued to monitor closely the airlines' operating and financial results, has encouraged the entry of new airlines by removing hindrances to market entry and assuring that new carriers are not harmed by unfair competitive practices. We are also continuing to reassess the economic impact of existing regulations in order to minimize regulatory burden on the industry.

Another important way to improving airline profitability is liberalization of routes, fares, and rates. Although the domestic industry has been deregulated for over 16 years, international routes are still subject to severe restrictions in many bilateral aviation markets. Liberalization of our bilateral aviation agreements with our trading partners, therefore, is another important goal of the Administration.

To achieve this, the Administration has adopted "Open Skies" initiatives with a number of our trading partners. The most dramatic fruit of this effort was the recent signing in Ottawa of the new U.S.-Canada aviation agreement. That agreement provides for complete "Open Skies" to be phased in over three years between the U.S. and the Canadian cities of Montreal, Toronto, and Vancouver, and for immediate "Open Skies" in all other U.S.-Canada markets. The Department has just issued temporary exemption authority to six U.S. carriers to provide new service to Montreal, two airlines to Toronto, and six to Vancouver. We expect the new U.S.-Canada agreement to result in several billion dollars in new trade between the two countries.

The Administration has also aggressively pursued "Open Skies" agreements with countries overseas. In the last few weeks, the United States has initialed "Open Skies" agreements with Austria, Belgium, Denmark, Finland, Iceland, Luxembourg, Norway, Sweden, and Switzerland. In addition, the Administration is seeking to improve bilateral agreements with a number of our other trading partners, including China, Japan, Peru, Poland, and the United Kingdom.

Successful implementation of "Open Skies" or liberalized bilateral agreements will provide U.S. airlines with more opportunities to compete on an even footing for increasingly valuable international traffic. Since U.S. carriers are the most cost-efficient in the world, we are confident such opportunities will result in increased profitability recovery.

In addition to the foregoing administrative actions, the Administration has proposed draft legislation to restructure FAA's Air Traffic Control functions in a new government-owned corporation funded by user fees. This would allow for more flexible personnel and procurement policies, ensure that the ATC system is able to respond quickly and efficiently to the growth of the industry and to technological advances, and provide for the highest degree of safety.

Last year, in response to recommendations of the Airline Commission, the Administration supported provisions in proposed legislation to reform the bankruptcy laws, including changes with respect to airlines. Last October Congress enacted the Bankruptcy Reform Act of 1994 we included several of the provisions we supported. In addition, on February 15, 1995, Representative Clinger introduced legislation in H.R. 951 to liberalize the restrictions on foreign ownership of U.S. carriers. Liberalization of foreign ownership rules was included in the Commission's recommendations, and has been adopted by the Administration in its Aviation Initiative and by the Department of Transportation in its recent international aviation policy statement. The Department is reviewing H.R. 951 in light of these factors.

Conclusion

With competitive pressures exerted by low-cost carriers, every major airline has launched a program to cut costs to the bone. These programs have included withdrawal from unprofitable routes and stations, retiring inefficient aircraft, reducing food service, changing distribution channels, shifting to ticketless reservations and booking, cutting commissions, and trading labor concessions for equity stakes in the airlines. These developments reflect the major changes going on in the airline industry as it restructures itself into a more efficient, highly competitive, and low-cost service industry. When these efficiencies are combined with today's health economy, and with our ongoing efforts to promote the health of this important economic sector, we see a profitable era for airlines.

Mr. Chairman, let me once again extend my thanks for the opportunity to present the Department of Transportation's views on the current and future health of the aviation industry. I am confident that, as our economy continues to grow, as U.S. air carriers become more efficient, and as the policies the Department has proposed or has underway are implemented, the aviation industry will grow, flourish, and prosper.

Chairman JOHNSON. Thank you, Mr. Murphy. I thank the three of you for your excellent testimony.

Mr. Ross, I assume from your testimony that the Department of Labor and the administration prefers not to create a new targeted jobs tax credit program, that in fact you think it would be difficult to create a program that would meet the principles that you have laid out, and you prefer the money to go into skill grants. Is that a fair statement?

Mr. ROSS. It is clearly the priority in the President's budget. We are working to consolidate, as you know, a considerable number of these different individual programs and we are trying to integrate them into resources that disadvantaged individuals, as well as laid-off workers, can use, get control of and take some charge of their own destiny.

We do support, as was suggested by Treasury, the continuation of the exclusion fully for employers who are investing in the training of their own workers.

Chairman JOHNSON. You are really making the point that government subsidies should not be aimed just at entry into the work force, but should be aimed at the attainment of quality jobs that will better support a standard of living of which we as a nation could be proud.

Mr. ROSS. I think that is right. Most folks can get first jobs. The point is not to get stuck there. There are some groups, those long-term welfare recipients, those perhaps who are on disability who need that jump start.

Chairman JOHNSON. I appreciate that, and I think that is a very important point. I want to keep my comments limited, as I am going to ask the others to.

Ms. Beerbower, would the Treasury oppose a change in the orphan drug tax credit that would require a company to, in a sense, make good on the subsidy they received early on, if an orphan drug then does become commercially very viable, very successful?

Ms. BEERBOWER. I think we would certainly consider that.

Chairman JOHNSON. Pardon?

Ms. BEERBOWER. We would consider that.

Chairman JOHNSON. The same issue I think needs to be raised in the exclusion of educational assistance. You can go to night law school for $3,000 a year, but we give educational expenses of $5,000. In this time of constrained budgets, is this rational? Would you be interested in looking at some of those kinds of things to better reduce the cost?

Ms. BEERBOWER. Sure, we would be happy to consider them.

Chairman JOHNSON Last, it is accurate to say that your position of support on some of these tax credits is not reflected in the President's budget. In other words, the cost of extension of the R&E, research and experimentation, tax credit, the cost of extension of the orphan drug credit and the allocation rules, and so on and so forth, are not accounted for in the President's budget?

Ms. BEERBOWER. In the President's budget, we support the extension of the credits, but you are correct that there is no financing offset that is provided in the budget, for the reason that we wanted to work with this Committee and with Congress generally to pro-

vide bipartisan financing options for these extensions, and we remain willing to look at—

Chairman JOHNSON. You will be willing to work with us to find offsets in the Code that represent lower national priorities?

Ms. BEERBOWER. Definitely.

Chairman JOHNSON. We appreciate that very much, and I will look forward to your input on that specific aspect.

Mr. Murphy, your statistics in regard to the transportation industry and the equity of extension were very interesting to me. There are others on the panel who are more knowledgeable regarding that matter, and I am going to yield to them.

I will recognize Mr. Matsui, my Ranking Member.

Mr. MATSUI. Thank you, Madam Chairwoman.

I would like to ask Labor, and perhaps Treasury, questions about the TJTC. From your answer to the Chairwoman's question, Mr. Ross, it seemed to me that you really do not want to see this program continue, you would rather like to see it expire, mainly because it cannot be reformed to your specifications. Is that pretty much my understanding?

Mr. ROSS. I would say that we do believe it would be possible. We can imagine the possibility of creating a credit for the disadvantaged that is much more effective than the old one. We would be willing to engage in it, not at the cost of scarce investment dollars for the disadvantaged.

Mr. MATSUI. We are talking about $1.2 billion, and it sounds to me that you are talking about—if you talked really about the disabled, you are really talking about a different kind of credit, because this is a much broader credit.

Let me say this. I would like to see it extended, at the same time it has to be reformed before I give my assent to it. All of you raised very legitimate concerns. I looked at the Inspector General's report, and last year we had some testimony on this issue. You are absolutely right, there is no reason why a Harvard graduate or a Harvard student should be able to qualify for this particular credit. These credits really go only for 6 months or less. I think the mean worker receives only 6 months out of these jobs. It is a rotational situation.

Mr. ROSS. Congressman, I would not want you at the same time to think we are not willing and more than interested in being forthcoming, if the Congress wishes to do this. We think it is important that it be effective based on the lessons of the past, and that hopefully it represents an expansion of our commitment to help the disadvantaged, not a substitute for something that works.

Mr. MATSUI. I am wondering if it would make some sense—and maybe you are already doing this—for you to meet with Mr. Houghton and Mr. Rangel and see if you can come up with something. I think that is the only way we are going to avoid a collision at the end, if you get administration and bipartisan support out of the Committee Members. Maybe you are already doing this. I do not know that. But I would recommend that, because, frankly, we do not want to be in a position where you have reservations and you must oppose the provisions that perhaps Mr. Rangel and Mr. Houghton agree to. It would not make sense.

Mr. ROSS. We do intend, in fact, I believe we even have scheduled time to meet with them yet this week. Yes, we will follow your advice.

Ms. BEERBOWER. The same on the Treasury side.

Mr. MATSUI. Good, and I would say the same with Treasury. Obviously, with the point of making sure that the costs of this is within a range that makes some sense. One thing you may want to consider—and perhaps Mr. Houghton and Mr. Rangel are looking into this—perhaps there could be some recapture provision, have a minimum length of time one would to be able to receive this credit, and whatever time that is would be something you would determine with the two principal sponsors, and then have the provision that if that person does not complete that time, you recapture it from the business.

I mean that is one way to make sure the business thinks it through before they hire that worker, not just put somebody on and take advantage of the credit and then throw them off without a lot of thought. I think the responsibility should be on everyone's side, not only the government and the employee, but the employer has to share in this responsibility and think through the well-being of that employee, as well.

There are some things that I think we need to look at, and that would be one. Perhaps it will not work. Maybe administratively it would be too difficult, but I would hope that you would look at some of these things with the idea of trying to make it work. If you cannot, we will obviously have to make tough calls.

Mr. ROSS. We will do that.

Mr. MATSUI. I thank all of you. Thank you.

Chairman JOHNSON. Mr. Herger.

Mr. HERGER. Thank you very much, Madam Chairman.

I have some questions, if I could. The point was made I believe by both Ms. Beerbower and also you, Mr. Murphy, about the fact that it would appear that the airlines are improving now. I guess my question is, when we look at this airline industry, which for a number of years has been struggling—we have three major airlines that are just pulling themselves out of bankruptcy.—If we look at 1994, even though our GDP, gross domestic product, was growing by 3.8 percent, we do show more than a quarter-billion-dollar loss by the industry. Some $285 million I believe for 1994.

I guess my question perhaps to you, Mr. Murphy, I just wonder what the rationale is at a time when the industry has been doing so poorly, that we are imposing on it a 4.3-cents-per-gallon tax on commercial aviation. Is it the administration's feeling that we can somehow tax what has been perceived by virtually all to be a weak airline into good health?

Mr. MURPHY. Congressman, the airline industry has historically been a very cyclical industry which responds in a magnified way to swings in the economy. Now that the economy has improved and the airlines have made some very fundamental changes, we believe they are on the brink of some very good times and that they have had the benefit of $1 billion over the last 2 years in a fuel tax exemption, and we believe they are now in a position to handle that without jeopardizing in any way their recovery.

Their fuel costs are now running about 55 cents per gallon, down from 70 cents per gallon in the midseventies, just a few years ago. We think the 4-cent-per-gallon tax is something they can absorb. We think the industry can continue to recover, and this will not jeopardize the health of any one airline.

Mr. HERGER. Following up on that again, we are just barely into this year, we are just into May. We have three airlines who have restructured and it would appear that maybe they are getting on their feet again. I have to assume that these three airlines plus the others have been cutting to the bone to try to get back into solvency. Again, I have to ask the question: Do we really feel that a $400 to $500 million annual tax on fuel is somehow not going to put them back into a tailspin?

Mr. MURPHY. We do not think it will put them in a tailspin. We estimated it will represent a 0.7-percent increase in their operating expenses. That is significant, but again we do not think it is going to jeopardize the recovery that is well under way and which I think is reflected by Wall Street.

Mr. JOHNSON of Texas. Will the gentleman yield?

Mr. HERGER. Yes.

Mr. JOHNSON of Texas. Does this mean that your agency is trying to run the airline industry from Washington, DC, and are you in effect saying that taxing is good for America, even if we lose an airline?

Mr. MURPHY. No, sir. We took a position that the airlines needed tax relief 2 years ago and the airlines did get a $1 billion 2-year exemption from the fuel tax. The issue in our mind is whether they continue to need that exemption that the other modes of transportation have not gotten—

Mr. JOHNSON of Texas. It is a judgmental call on your part, without probably even talking to any of the chief executive officer's or any of the airlines.

Mr. MURPHY. Sir, we do talk to the chief executive officer's on a regular basis and clearly none of them are going to—

Mr. JOHNSON of Texas. They do not want a tax increase, do they?

Mr. MURPHY. None of them are going to support a tax increase, Congressman, no, sir.

Mr. JOHNSON of Texas. Thank you.

Mr. HERGER. Concluding, does the administration feel there is a possibility that some of these airlines who again are struggling, could perhaps result in bankruptcy?

Mr. MURPHY. We do not believe this one element could, but I also do not want to leave you with the impression, Congressman, that none of our airlines have problems. There are still two or three airlines that need to continue to restructure. As an industry, we believe they have turned the corner, we continue to have new entry into the industry, and some of our airlines are going to have a very good year this year from a profits standpoint.

Mr. HERGER. Then you are saying the administration feels that it is worth the risk at this time to impose this tax, even though there is a risk of—

Mr. MURPHY. We do not think this one item is going to drive any one airline into liquidation. There are some airlines that have problems that go well beyond this tax issue that have to do with their

fundamental costs, and they are going to have to continue to work on those.

Mr. HERGER. I hope you are correct in your assumptions. I have a major concern with what you are attempting to do. I do not think it is the right thing to do, particularly right now following the incredible loss that the airlines, as a whole, have been dealt just this last year. I also am concerned about the message that the administration is sending the businesses of our country that the minute you begin to look like you are getting your head above water, look out, because here comes the government to take more out of your pocketbook. I am very concerned about that, as well.

With that, I end my questioning, Madam Chair.

Chairman JOHNSON. Thank you, Mr. Herger.

Mr. Zimmer.

Mr. ZIMMER. Thank you.

I would like to ask Ms. Beerbower to respond to a couple of specific suggestions with respect to changes in the R&E credit on behalf of the administration. Assuming that acceptable measures to offset the cost of these proposals could be found, would the administration support providing taxpayers with a one-time election to take a flat 3-percent credit in lieu of the current incremental credit?

Ms. BEERBOWER. We would consider discussing with you the modifications of the research tax credit, but in the context that the most important thing to us about it is that it be made permanent. If in discussing modifications, issues arise as to different groups being helped, hurt or whatever, if that in any way retards making it permanent, making it permanent would be our highest priority.

On a flat rate versus an incremental rate, we have in general tried to have the credit respond to increased research, as opposed to research that would have otherwise been undertaken by the taxpayer. We see a flat credit as subsidizing research that might have otherwise occurred.

Mr. ZIMMER. Even on a one-time basis, you would not be receptive to this effort?

Ms. BEERBOWER. We would consider it, but, as I said, the highest priority of the administration is to make it permanent.

Mr. ZIMMER. Well, assuming that we can make it permanent somehow, and assuming that we can make it revenue neutral somehow, let me go on to the second suggestion. If you had a reform providing taxpayers with an opportunity to adjust their fixed base period to a fresh start approach or by allowing taxpayers to choose any consecutive 4-year period, say out of the previous 8 years as their base period, is that something you would consider?

Ms. BEERBOWER. We would consider it.

Mr. ZIMMER. Would you support it?

Ms. BEERBOWER. Your assumptions are that we have financing options and we have already made it permanent. I think at that point we would be happy to work with you to modify it.

Mr. ZIMMER. This brings me to a larger point. You said just now and before that the administration wants to work in a bipartisan manner to come out with ways to offset the cost of these extensions. We are running out of time. These extensions are about to

expire, and I would like to know whether you today have any suggestions of specific ways that we can offset the revenue loss?

Ms. BEERBOWER. We do have ideas. Again, the importance to us is the bipartisan nature of expressing our ideas, so they are not ideas that we would announce but we are happy to work with you with respect to those ideas.

Mr. ZIMMER. What exactly does that mean? Because Donna Shalala used about the same terminology when she said she wanted to work with us on Medicare, dealing with the anticipated bankruptcy of the Medicare Trust Fund. How do we get going on this bipartisan discussion?

Ms. BEERBOWER. I think one of the things that encouraged us in this way was our experience with respect to GATT, General Agreement on Tarrifs and Trade, and also just recently with the 25-percent health care deduction for the self-employed. We assembled a working group, people presented ideas for financing, the financing options were presented in a bipartisan fashion, and we thought that worked quite well. Particularly in GATT, it was a very successful effort and it was at a staff level with a working group meeting.

Mr. ZIMMER. How did that working group get put together? Who took the initiative to put together the working group?

Ms. BEERBOWER. I cannot recall in GATT. In the 25-percent health area, I think it was the Joint Committee. We are happy to take the initiative. If you take the initiative, we are happy to attend the meeting. We have ideas and we would be happy to discuss them.

Mr. ZIMMER. I just hope we get off the dime, I look forward to working with you.

Thank you very much.

Chairman JOHNSON. Mr. Levin.

Mr. LEVIN. Thank you.

Let me just ask you a question about the excise tax, because I do not really think it is quite fair to say it is a question of hitting business as soon as it is profitable. I think the question here is whether an exemption from a tax that applies to other businesses should be continued. I have an open mind on that. I think it is important that we look at it in a fair way.

Later on, there is going to be testimony that says this. Forget for a moment—though I do not think you can for more than a second—the issue of profitability within the airline industry, which I think is subject to a lot of discussion, what the longer range prospects are.

The airline industry also says you have to look at the comparative impact of taxation among various transportation modes, and I think that is true. I do not know if you have seen Carol Hallett's testimony, but she compares taxation on the various transportation industries and indicates that the airlines are already paying much more. What is the appropriate response?

I think that you would agree we have to look at the overall burden on the various transportation modes. No?

Ms. BEERBOWER. I think your point is an excellent one in terms of putting this issue in context. When Congress enacted the 4.3 cent excise tax, it was intended to apply to all methods of transpor-

tation. At that point, there was a request for a special industry exemption for the airlines to last I believe only during the 2-year period. It was Congress' intention that it apply to all modes of transportation and that this particular exemption be only for the severity of the particular problems that were being faced at that point by the airline industry.

It would be inappropriate, in considering the extension, unless Congress should decide it, rather than in considering whether or not to impose the excise tax on airlines at all, and in that kind of a discussion one would look at tax burdens on relative forms of transportation.

Mr. LEVIN. Should we not do that?

Ms. BEERBOWER. The question before us is whether to extend the exemption for the airlines.

Mr. LEVIN. But it is relevant, is it not, to look at the overall tax burden? Maybe a few years ago we did not apply it to aviation because there was an immediate crisis, so we did not need to look at the larger issue of overall burden. I would think we would have to take into account subsidies, too. I am not sure of the full picture, but do you not think it is appropriate to look at overall tax burden within the transportation industry?

Mr. MURPHY. If I could, Congressman, much of the tax on these transportation companies goes into trust funds, and then one has to look at what does it cost the Federal Government to provide the infrastructure and support for different forms of transportation. We know it is substantially lower, let us say, for the railroads than it is for airlines, where we have to provide radar, air traffic control systems, we have to provide inspectors, and security. There is a cost to the Federal Government, as well as a burden on the industries.

Mr. LEVIN. Has anyone made that analysis?

Mr. MURPHY. Yes, sir, a lot of analysis on that.

Mr. LEVIN. Why don't you send it to us.

Mr. MURPHY. Yes, sir, we will be happy to.

Mr. LEVIN. In other words, answer the question for the record of the relative tax burden and take into account subsidization.

[The following was subsequently received:]

DIRECT FEDERAL TAXES FOR SELECTED TRANSPORTATION MODES
Fiscal Year 1994
($000,000)

	Actual FY 1994			With the Aviation Fuel Tax		
Commercial Aviation	Total	Trust Fund	General	Total	Trust Fund	General
Fuel						
Deficit reduction	$ -	$ -	$ -	$ 379.0	$ -	$ 379.0
LUST	$ 12.5	$ 12.5	$ -	$ 12.5	$ 12.5	$ -
Passenger ticket	$ 4,747.0	$ 4,747.0	$ -	$ 4,747.0	$ 4,747.0	$ -
Freight waybill	$ 330.0	$ 330.0	$ -	$ 330.0	$ 330.0	$ -
International departure	$ 224.7	$ 224.7	$ -	$ 224.7	$ 224.7	$ -
Total taxes	$ 5,314.2	$ 5,314.2	$ -	$ 5,693.2	$ 5,314.2	$ 379.0
Total Revenue	$ 65,748.0			$ 65,748.0		
Taxes as a share of revenue	8.1%	8.1%	0.0%	8.7%	8.1%	0.6%
Commercial Trucking						
Fuel						
Highway Trust Fund	$ 4,392.6	$ 4,392.6	$ -	$ 4,392.6	$ 4,392.6	$ -
Deficit reduction	$ 1,752.4	$ -	$ 1,752.4	$ 1,752.4	$ -	$ 1,752.4
LUST	$ 25.1	$ 25.1	$ -	$ 25.1	$ 25.1	$ -
Tire tax	$ 357.5	$ 357.5	$ -	$ 357.5	$ 357.5	$ -
Retail sales tax 3/	$ 1,635.7	$ 1,635.7	$ -	$ 1,635.7	$ 1,635.7	$ -
Highway use tax 4/	$ 650.3	$ 650.3	$ -	$ 650.3	$ 650.3	$ -
Total taxes	$ 8,813.6	$ 7,061.2	$ 1,752.4	$ 8,813.6	$ 7,061.2	$ 1,752.4
Total revenue	$ 88,600.0			$ 88,600.0		
Taxes as a share of revenue	9.9%	8.0%	2.0%	9.9%	8.0%	2.0%
Railroads						
Fuel						
LUST	$ 2.8	$ 2.8	$ -	$ 2.8	$ 2.8	$ -
Deficit reduction	$ 190.2	$ -	$ 190.2	$ 190.2	$ -	$ 190.2
Total taxes	$ 193.0	$ 2.8	$ 190.2	$ 193.0	$ 2.8	$ 190.2
Total revenue	$ 33,007.0			$ 33,007.0		
Taxes as a share of revenue	0.6%	0.0%	0.6%	0.6%	0.0%	0.6%

Mr. Ross, let me just ask you about the targeted jobs tax credit. I so much applaud what the Secretary and you have been doing in terms of job retraining. I do think it has been somewhat an unheralded effort to this point. In terms of America's future competitiveness, what you are trying to do to restructure training and retraining I think will be more durable than a lot of other things that we are doing.

I hope we can join in a bipartisan basis to do something and do something this session. Within that context—I know you are working on the whole package, you are trying to consolidate, trying to rationalize, trying to squeeze programs, make them more effective—you are a bit hesitant to take the targeted jobs tax credit by itself. I think that is understandable.

Just briefly within your overall effort to rationalize training—and we know how to do training, and you have been a leader for years—we know how to retain in this country. What is your message on the targeted jobs tax credit, that you are willing to work to reform it, that you do not think, no matter what we do, it would be very high up on the priority list of reformation of the system? But, again, you are willing to work to make it as strong as possible? Just summarize with your expertise, and I think your unique commitment combined with Secretary Reich and this administration, where you are coming from on this.

Mr. ROSS. We believe that under any circumstances, but especially in the setting in which dollars are short, that it is critical to invest in things that have demonstrated some ability to earn a return. We all agree that moving particularly low-income young people into the mainstream of the economy has as big payoff, economic and social.

The Job Corps, we know, returns about $1.46 in benefits for every dollar invested. Can it be improved? Sure, but that is a positive return. I can show that to a taxpayer. In TJTC, we were not able to demonstrate consistently any kind of positive return on those dollars. If there is a strong desire to use the tax credit as one of the means of helping the disadvantaged, I think we all agree we have got to learn from the past and get a positive cost benefit out of it.

Second, how much we invest in it needs to be determined in the context not only of the whole budget, which I know all of you are doing, but in the context of alternative investments in the disadvantaged that have some track record. I mean, part of this is, keep what works and get rid of what does not. That is what all of us are being instructed by the electorate to do. That is the framework within which we would like to look at. We are willing to work with you, if there is a desire on the part of the Committee to do so.

Mr. LEVIN. I think there is, and we look forward to working with you.

Thank you.

Mr. ROSS. Thank you, Congressman.

Chairman JOHNSON. Just to clarify the paper that you are going to get back to us from Mr. Levin's remarks, Mr. Murphy, it would be helpful if you would clarify for us all of the government's subsidies that support the different modes of transportation, including

the Highway Trust Fund and the tax sources, so we can get a better view of the role that the government plays in supporting each of our primary transportation modes.

Mr. MURPHY. We will be happy to do that.

Chairman JOHNSON. Thank you.

Mr. Johnson.

Mr. JOHNSON of Texas. Thank you, Madam Chairman.

While you are at it, how about including the costs that the airlines pay to the various airports around the country to provide their sustenance in addition to taxes that go into a trust fund that has not been used properly.

Ms. Beerbower, you were reluctant to talk about airline taxes overall or taxes overall on transportation, because you indicated that this hearing was simply on renewing the airline exemption. However, in your testimony you talked of other things that were not part of this hearing. The oil spill liability tax, for example, which you are pushing. Can you tell me why you want that extra money and what you are going to do with it? Further, why do you intend to take the cap, the statutory cap off in your proposal?

Ms. BEERBOWER. Yes, my hesitancy to discuss the tax burden on the airline industry was a resistance to the use of the word "tax." I think the better expression, which I feel quite comfortable with, is what is the government subsidy of transportation for one industry relative to another, and not focus entirely on the taxes that are borne by those industries.

Mr. JOHNSON of Texas. It is still tax, with any name you put on it. Go ahead and use whatever term you like.

Ms. BEERBOWER. On the Oil Spill Liability Trust Fund, we support the extension of the tax. We have been looking at the current balance—

Mr. JOHNSON of Texas. The tax expired, as I recall, and in one case there was a cap of $1 billion, I believe. When the fund acquired that much money, it automatically went off. I guess it went a little below that and went back on and then ultimately expired totally. Why do we need it?

Ms. BEERBOWER Well, at the current moment you are right that the balance of the fund is in excess of $1 billion dollars slightly because of the investment return. We think that the mechanism needs to be in place because of the fluctuation of the value of the trust fund, to kick it back in should there be a large oil spill liability and the fund is reduced below $1 billion.

Mr. JOHNSON of Texas. Your proposal eliminates the cap.

Ms. BEERBOWER. Our revenue estimating eliminates the cap. It assumes the cap goes up slightly over the years. A question we would certainly be willing to consider is whether or not the $1 billion needs to be increased or not, relative to the cost of the possibility of oil spills or whether $1 billion is adequate. In any case, we think the mechanism needs to be in place to reimpose the tax quickly, should the revenues in the trust fund go below $1 billion.

Mr. JOHNSON of Texas. How is that money being used? Is that being used to offset deficits, or is it being used as it is designed? Has it been tapped recently?

Ms. BEERBOWER. Well, it is currently at $1 billion in the fund. It is my understanding that the fund is used to clean up oil spills. I do not think it goes to another purpose, but we can check on that.

Mr. JOHNSON of Texas. Has there been any deductions from it recently?

Ms. BEERBOWER. Apparently there was a Puerto Rican oil spill about 6 months ago that reduced the balance in the fund below $1 billion and triggered the tax on again.

Mr. JOHNSON of Texas. How did it trigger the tax on, if it expired last year? Why don't you let your assistant talk? I think the Committee would allow that.

Ms. BEERBOWER. This is Elizabeth Wagner, our staff assistant in charge of it.

Ms. Wagner.

Ms. WAGNER. The tax went back on as of last July because of funds that were expended—that was more than 6 months ago, obviously—for a large oil spill near Puerto Rico.

Mr. JOHNSON of Texas. Was that a U.S. ship or a Puerto Rican ship?

Ms. WAGNER I am not sure, sir. Therefore, the tax did go back on as of July 1 last year, and the tax expired as of the end of last year.

Mr. JOHNSON of Texas. There is $1 billion in the fund right now?

Ms. WAGNER. There is $1 billion in the fund right now. There are annual disbursements for smaller spills of between $100 and $200 million per year, and they anticipate that that will continue. Therefore, if the tax is not extended or—

Mr. JOHNSON of Texas. Is that real money or paper money? Is it being invested? Is it drawing interest? Is it real money or is it being used against the debt?

Ms. WAGNER. It is drawing interest, and that is why there is an excess in the fund today. The interest is going into the fund.

Mr. JOHNSON of Texas. Thank you for your testimony. I am not sure that we need to redo that one, if it is operating and functioning the way it is by itself.

Chairman JOHNSON. My understanding of what you are saying is that if there were a big oil spill off the coast of New York City and the fund was drawn down without renewal of the law, there would be no way of replenishing the fund.

Ms. BEERBOWER. That is correct.

Chairman JOHNSON. Thank you.

Mr. Collins.

Mr. COLLINS. Thank you, Madam Chairman.

Mr. Levin, you were referring to the different taxes overall in the transportation industry. A bit of information, and I know there are some other overlapping tax provisions or costs to other industries other than the airline industry as far as transportation.

If you took the laundry list of taxes that the airline industry has collected today versus the fuel it purchases and converted those taxes to per-gallon fuel tax—and this is not including the 4.3 cents per gallon that is projected to be proposed for October—the airline industry will be paying an equivalent to 52.5 cents per gallon with current taxation. As that compares to the trucking industry, it is a little over twice or 100 percent more than the trucking industry.

Compared to the railroad industry, it is better than 600 percent of what the railroad industry is paying.

Mr. LEVIN. Would the gentleman yield?

Mr. COLLINS. Yes.

Mr. LEVIN. I notice that in Ms. Hallett's testimony and that is why I think you would agree that it would be wise for us to have any comments from the administration, because I do think that is relevant, the overall burden.

Mr. COLLINS. I think the gentleman is right, and not only from the standpoint of being a Member of Congress, but also having been in the transportation business myself for some 30 years, and not in the airline business.

The passenger fee was increased when NAFTA was approved for those funds to be applied to the cost of NAFTA. The Highway Trust Fund was increased from 8 to 10 percent, with 2 years of that being applied to deficit reduction. I think the airline industry itself has paid a major portion of the tax.

Mr. Murphy, your testimony suggests that the airlines can now absorb this tax because of recent marginal improvements in their financial statements. I assume that those marginal improvements makes them tax worthy. In the eyes of the Department of Transportation, what type of profits would it take to make them creditworthy so that they would have a reduction in the cost of capital that they have to borrow for investment or borrow for operations, which would lower their cost of operation and increase their tax liability on the other end? What would you say they would have to accumulate in profits over the next few years to put them back into a creditworthy position?

Mr. MURPHY. Our view, Congressman, is that the airline industry has not just undergone some marginal improvements in profits, but that some fundamental structural changes have taken place in the industry over the last few years, and the industry is now in a position to do very well.

In terms of what level of profits are needed for the next few years to raise their credit ratings, I could not answer that question. I think I would have to defer to someone in the investment banking industry. We do know, however, that some of the firms on Wall Street are now firmly recommending that certain airlines are equities and ought to be bought by investors.

Mr. COLLINS. Would not an increase in profitability lower their cost of money, which would increase their tax liability on the other end? You say you do not take that into consideration at all?

Mr. MURPHY. I said I do not know at what point their credit ratings will increase, how much profit that would take.

Mr. COLLINS. You are just focused in on the fact that they are now beginning to improve their situation to make a profit, so that makes them taxworthy. You are not concerned about creditworthiness?

Mr. MURPHY. I do not want to mix creditworthiness and the ability to continue to defer a tax. Our view is again they are in a position to begin to pay that tax that has been deferred for 2 years.

Mr. COLLINS. When you said they are improving financially because of restructuring, is it not true that that restructuring came at the cost of a number of employees through layoffs and also a cut-

back in the purchase of equipment, which again led to layoffs in the aircraft industry? The restructuring may have helped them in one area, but it costs in another, and every time we lost an employee we also lost a tax deduction from a payroll check. Is that not true?

Mr. MURPHY. Certainly both those facts are true. If I could just clarify slightly, the employment levels in the airline industry were growing in the eighties. They have more or less leveled off in the nineties. If we look at all of the people who have left the industry and then all the people who have entered the industry, employment has been flat in the airline industry.

In addition, the airlines have postponed purchases of aircraft. That was one of the problems. There was too much capacity in the system, and we believe they have now wrung most of that excess capacity out of the system, and that is one of the reasons they will return to profitability.

Mr. COLLINS. It came at the expense of individual loss of jobs and employment, which also resulted in the loss of tax deductions through those payroll checks that would have been received by those individuals.

You are interested in the fact that the airline industry is now enjoying a low fuel cost and that this tax will only increase their operation by 0.7 percent. Is that not the figure I remember you saying?

Mr. MURPHY. Seven-tenths of 1 percent, yes, sir.

Mr. COLLINS. Seven-tenths of 1 percent. What would a 10-percent cost increase in fuel do to that operating figure of 0.7 percent?

Mr. MURPHY. I would have to run those calculations, Congressman. I could not do that in my head.

Mr. COLLINS. Well, is it not true that fuel cost is now on an upward swing?

Mr. MURPHY. Fuel has been holding in the 50-cents-per-gallon range for about the last year. Fifty-five cents per gallon is the last figure we have for domestic fuel.

Mr. COLLINS. We will hear testimony on that later.

You mentioned the CEOs. Naturally, they would not prefer to see any type of tax increase on their airline. What about the business community? Will the airline be able to pass along part of this increase to other businesses? The flying public and business executives. Is it not true that an increase in their operations will result in a decrease in their tax liability, which again will affect the revenues of the Federal Government in a different fashion?

Mr. MURPHY. It is true that a large portion of this increase will be passed on to the users of the system.

Mr. COLLINS. Which will increase the cost of their business expense, and lessen the tax liability that they will be exposed to.

Mr. MURPHY. That is true.

Mr. COLLINS. It is a never-ending cycle, is it not, kind of like getting on the beltway and trying to find the end of it.

Mr. Ross, I am not surprised to hear the administration's position on the job tax credit. I had the opportunity to discuss this particular issue with the President the other day, and we both voiced concern about the individual tax credit and how it is working.

I suggest that you look at the concentration of welfare, unemployment, and crime, and you will find it exists actually in about 5 different States or 10 cities around the country, or better than 50 percent or right at 50 percent of all of those. Businesses in the private sector are going in there at their expense, not with any kind of government subsidy, and establishing operations that will employ people, and also focus in on industry that we are losing to other parts of the world.

We have lost a lot of jobs, particularly in the area of textile and apparel. If there is any possibility through favorable tax rates to an individual to a business or manufacturer who would spend their money, take their risk and investment in those areas to create jobs without any further government involvement, I believe that is a program and a plan that would have some purpose and merit to it.

Thank you, Madam Chairman.

Chairman JOHNSON. Thank you, Mr. Collins.

Mr. Hancock briefly, and Mr. Matsui very briefly.

Mr. HANCOCK. Thank you, Madam Chairman.

Mr. Murphy, is your projection that the 4.3-cents-per-gallon tax increase will be absorbed or that some of it will be passed through to the airlines' customers? If in fact it is all passed through, would there be a reduction in their profitability?

Mr. MURPHY. If they were all passed through, we would presume that there would be somewhat less travel, because higher costs would result in less travel. Yes, their profitability could be reduced.

Mr. HANCOCK. If in fact they do not pass it all through, then their profitability is automatically reduced?

Mr. MURPHY. Yes, although we believe that when their costs go up, they will make some adjustments in the efficiency in the way in which they operate their fleet. As the cost of fuel goes up, they look for ways to continue to save fuel.

Mr. HANCOCK. Is that not a little bit on conjecture? Let me ask it this way. Is it more likely that they will continue on the road to profitability without the tax increase or with the tax increase? Which way is more likely?

Mr. MURPHY. Without the tax increase, Congressman.

Mr. HANCOCK. Then I think that answers our question, does it not? We want the airlines to get on a profitable basis. Over the past 5 years, the airline industry, the investors, the stockholders in these companies have lost $13 billion. Now, how do we get into a profitability basis to where those losses can be recovered? I think that is where we have got to go.

Since they cannot pass it all through because it decreases demand for their services, they are going to lose money. If we put the 4.3 October projections in there, they are going to lose money, more money than they are losing now. That is a long way to go to get to profitability.

I especially appreciate the statement about credit-worthiness. It seems to me, when you talk about 0.7 percent, that does not amount to much. That amounts to a whole bunch when you start talking about big business spending or borrowing money. When they borrow money, they carry it out five or six places. Seven-tenths of 1 percent is a big chunk of money. Let's get them back

on the road to profitability before we start talking about taxing them.

Mr. COLLINS. Would the gentleman yield?

Mr. HANCOCK. Certainly.

Mr. COLLINS. I believe the average fuel cost for the industry is about 12 percent of their operating costs. An upswing of 6 percent in fuel costs would nullify the 0.7 percent that the gentleman is referring to.

Mr. HANCOCK. Let's give them another 2 or 3 years before we hit them again.

Thank you.

Chairman JOHNSON. Mr. Matsui.

Mr. MATSUI. Thank you, Madam Chairwoman.

I understand that Treasury will not be here tomorrow on the R&E credit and also the 861 allocation of R&E expenses. I would like to just ask a question on the latter now.

Ms. Beerbower, in your testimony, you indicated that the Treasury Department may come up with new regulations on the 861 allocation issue that would be more favorable to the taxpayers. Could you maybe answer two questions in that respect. When do you think you might have new regulations, and does that mean we would not have to act? Second—and maybe it is premature to ask this question—what do you have in mind in terms of this being more favorable for the taxpayers?

Ms. BEERBOWER. I apologize for not being able to announce the regulations at the same time as the hearing. The timing of the issuance of the regulations should be very soon. We are in the final stages of clearance, and so we hope to issue that very soon. Whether or not that means that this Committee will want to act or not act is clearly in the judgment of the Committee.

I cannot at this point go into the details of the regulations and what they do that make them more favorable than the 1977 regulations, but certainly when they are released, we are happy to brief you and go over what changes are in them.

Mr. MATSUI. When you indicate you will be perhaps making these proposed regulations very shortly, are we talking about a matter of weeks or a matter of months or—

Ms. BEERBOWER. I wish I could always predict. I would have said a matter of days, but do not hold me to that in case there is a delay. We had hoped to release them this morning.

Mr. MATSUI. Thank you very much.

Chairman JOHNSON. I share Mr. Matsui's concern. We are the chief sponsors of the extension legislation. As soon as you are able to release them, I want to set up a briefing for the Committee, so that we can understand which of the problems in that area may need our attention.

Ms. BEERBOWER. Certainly.

Chairman JOHNSON. We will schedule that, if you will let us know as soon as possible when you could talk with us.

Ms. BEERBOWER. Certainly.

Chairman JOHNSON. Thank you.

I thank this panel for your very good testimony, right to the point. I appreciate it.

As this panel is leaving, we are going to ask Mr. Camp to join us. He was unable to get here at the beginning. Dave, if you will try to observe the 5-minute rule, because we have a very long list of people testifying today.

STATEMENT OF HON. DAVE CAMP, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MICHIGAN

Mr. CAMP. Thank you. I will be brief. I want to thank the Chair and my fellow Members.

I am here to testify in favor of H.R. 733, which is legislation that will make permanent the full deductibility for gifts of publicly traded stock to private foundations. I understand the Committee will be hearing from the Council on Foundations later today.

In the interest of time, I will not spend a lot of your time discussing the importance of foundations to our communities. I think we all understand full well the impact these foundations have. In Michigan alone just in recent years, we have had 52 private foundations that were recently founded with publicly traded stock, and their assets total more than $82 million. Their annual grant making is more than $4 million.

I would like to discuss the legislation briefly. Prior to 1984, the foundation population was about 22,000 and it was shrinking. After the 1984 Tax Code amendment which permitted living donors to deduct the full fair-market value of these gifts, the number began to rise, and by 1992 nationwide foundations had grown to 35,000, and that is increasing.

Ten years after that amendment, the provision has sunsetted. The loss of this full deduction has put at risk the formation of new foundations by living donors, and I do not believe we can let this happen.

I would also like to briefly discuss H.R. 734, which is also part of this legislative package introduced by Congressman Jacobs and myself. Specifically, H.R. 734 would permit private and community foundations to establish tax-exempt common investment funds. This legislation fixes a quirk in present law which allows common funds for other charitable organizations such as universities and other public charities, but not community foundations which are also charities.

H.R. 734 would bring these foundations an economy or efficiency of scale which would allow them to make investments which can often make the difference between a good investment and a mediocre one. They would also allow these foundations to use more profitable vehicles for their investments, and in the end that would mean the grant making would increase in our communities and the people that our communities serve would be better off.

There are currently over 450 community foundations across the United States, and in 1993 they gave over $730 million in charitable grants. They are the fastest growing segment of philanthropy today, so we must continue to encourage this growth and offer incentives we can to promote these foundations as a valuable resource to American communities.

This legislation not only gives existing foundations the opportunity to expand and increase the return on their donations, but it will also encourage the creation of other new foundations to

maintain and enhance the fabric of their communities. I encourage support of both of these pieces of legislation.

I want to close by saying that these foundations are an important part of our communities, any community, for that matter, and I would like to see our Committee do what it can to encourage and enhance their activities.

Thank you.

Chairman JOHNSON. Thank you, Mr. Camp.

I, and I imagine every Member, am keenly aware of the growing role that foundation funding is playing in helping communities to meet their most local and pressing needs, and also serving as a vehicle through which we are better able to integrate existing services by providing some muscle at the local level for a better level of integration and overcoming of some of the local turf battles that often prevent more effective services. This is an area of some concern and I appreciate your testimony.

Mr. CAMP. Thank you. I also want to thank the Chair for cosponsorship of both of those bills.

Chairman JOHNSON. Thank you.

Mr. Levin.

Mr. LEVIN. It is a matter I think we are going to spend some time on, so your participation is going to be, as usual, very important.

Mr. CAMP. Thank you.

Mr. LEVIN. Thank you.

Chairman JOHNSON. Thank you, Dave.

The next panel will come forward: Carol Hallett, president and chief executive officer of Air Transport Association; Charles Barclay, president of the American Association of Airport Executives; and William Norman, vice chairman of the Travel and Tourism Government Affairs Council. While each of you has many more things after your names, I think those introductions will do.

We will start with Carol Hallett. We do have a very long agenda, so I would ask that the lights now be employed both for those who are testifying and for those who are questioning.

Thank you.

STATEMENT OF CAROL HALLETT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, AIR TRANSPORT ASSOCIATION OF AMERICA

Ms. HALLETT. Thank you, Madam Chairman and Members of the Subcommittee.

I am Carol Hallett and, as you have indicated, president and chief executive officer of the Air Transport Association of America. I am here on behalf of our member airlines which transport more than 95 percent of all passenger and cargo traffic. You have received my full testimony and I do ask that it be submitted in the record.

My testimony also represents the views of the Airline Pilots Association, the Aerospace Industries Association, and United Technologies Corp. We thank you for the opportunity to discuss the commercial aviation fuel tax that is scheduled to be imposed on October 1 of this year.

The commercial airline industry, as has been stated this morning, has collectively lost more than $13 billion since 1990. The last year of black ink was in 1989. Since 1990, nearly 250,000 U.S. airline and aircraft manufacturing employees have lost their jobs. Seven major passenger airlines have filed Chapter 11 bankruptcy, and three major U.S. airlines have ceased to exist altogether.

Many airline employees have made substantial wage and benefit concessions, and total airline industry concessions now exceed $1 billion annually. Imposition of a 4.3-cents-per-gallon jet fuel tax on our industry would invalidate these employee concessions and seriously undermine the progress made by airlines over the past few years to lower costs, increase productivity and efficiency. Some of the financially weaker carriers may not survive. As Gerald Greenwald, chairman and chief executive officer of the United Airlines recently testified; "dead companies do not pay taxes."

While the industry's losses accumulated by the billions of dollars over the past 5 years, government-imposed taxes and fees increased significantly faster than any other single airline cost. As many of our Nation's industries are reporting record profits, the airline industry, which has not had a profit since 1989, is being hit with this new tax of $527 million, in addition to the estimated $6.5 billion the airline industry already pays annually in federally mandated taxes and fees.

Charts accompanying my written testimony display the rapidly increasing excise taxes and user fees over recent years, as well as the strong relationship between airline losses and these rapidly increasing government-imposed taxes and fees during the same period.

How does the airline industry compare to other industries in transportation with regard to the federally mandated fuel taxes? The commercial trucking industry pays a Federal tax of 18.4 cents per gallon for gasoline and 24 cents for diesel fuel, while the railroad industry pays a total of 6.9 cents per gallon, as Mr. Collins indicated.

To put this into perspective, if the $6.5 billion the airline industry already pays annually in federally mandated excise taxes were instead assessed in the form of a transportation fuel tax on the fuel we buy in the United States., our industry is effectively already paying, as Mr. Collins pointed out, a 52.5-cents-per-gallon tax.

Many suggest that carriers should pass on the additional cost of these new and increased taxes by charging higher air fares. If this were possible, the industry would have done this long ago, rather than confront the numerous adverse consequences associated with losing an industrywide $13 billion.

During the past few years of widespread industry losses, airlines have not been able to raise fares to cover costs. In fact, carriers have been forced to lower their fares to attract customers. Fortunately, many in the new Congress understand the impact of a new half billion dollar tax and we appreciate their willingness not only to testify before you today, but we also greatly appreciate Representatives Collins and Dunn for their strong support in sponsoring the legislation to repeal the commercial aviation jet fuel tax.

We also appreciate the cosponsors of the bill and, more importantly, we are extremely thankful to Speaker Gingrich, to Chair-

man Shuster and the leadership of the House Transportation Committee for their broad bipartisan support. We urgently ask the Congress to continue this momentum and repeal the commercial aviation jet fuel tax.

Madam Chairman, I greatly appreciate the opportunity to appear before you today, and I would be more than happy to respond to your questions.

[The prepared statement and attachments follow:]

Statement of Carol Hallett
President and Chief Executive Officer
Air Transport Association of America
Before the Subcommittee on Oversight,
Committee on Ways and Means
On the Impact of the Commercial Aviation
Jet Fuel Tax on the Airline Industry

May 9, 1995

Madam Chairman and members of the Subcommittee, I am Carol Hallett, President and Chief Executive Officer of the Air Transport Association of America. ATA represents the major carriers of the U.S. airline industry; our members transport more than 95 percent of all passenger and cargo traffic moved on U.S. flag carriers. On behalf of our member airlines,* I appreciate the opportunity to appear before you today to discuss an expiring provision of the tax law which could have a devastating impact on the financial well-being of our industry: the commercial aviation fuel tax scheduled to be imposed on October 1 of this year.

The extreme difficulties faced by our member airlines have been piling up through more than five years of financial losses. Rarely does a day pass that I do not have a discussion with at least one of our C.E.O.'s regarding the adverse consequences this new, additional tax will have on their company. Madam Chairman and members of the Subcommittee, this commercial aviation fuel tax would be a financially crippling blow on this industry.

As you are probably aware, the commercial airline industry has collectively lost more than $13 billion since 1990. The last year of black ink was 1989, when the industry reported a $128 million net profit, slightly better than breakeven. In the intervening period, our industry lost $3.9 billion in 1990, $1.9 billion in 1991, $4.0 billion in 1992, $2.1 billion in 1993, and $285 million in 1994.

Since 1990, nearly 120,000 airline employees and 125,000 U.S. aircraft manufacturing employees have lost their jobs. Further, nearly half of our major passenger airlines have been forced to file Chapter 11 Bankruptcy, and three major U.S. airlines have ceased to exist altogether. Many airline employees whose jobs have not been eliminated have made substantial wage and benefit concessions, and total airline industry concessions now exceed one billion dollars annually. At one company, employees recently gave wage and benefit concessions totalling in excess of $4.9 billion over nearly six years, in exchange for majority ownership of the company. At other carriers, employee concessions have averaged between 10 and 14%.

At a minimum, a new Federal tax in excess of one-half billion dollars annually would invalidate these employee concessions and seriously undermine the progress made by airlines over the past few years to lower costs and increase productivity and efficiency. More likely, the distinct possibility exists that some of the financially weaker carriers simply would not survive. And, as Gerald Greenwald, Chairman and CEO of United Airlines succinctly stated recently: "Dead companies don't pay taxes."

Distressingly, while the industry's losses accumulated by the billions of dollars over the past five years, government-imposed taxes and fees increased significantly more, and significantly faster, than any other single airline cost.

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* ATA member carriers include: Alaska Airlines, Aloha Airlines, American Airlines, American Trans Air, America West Airlines, Continental Airlines, Delta Air Lines, DHL Airways, Evergreen International Airlines, Federal Express, Hawaiian Airlines, KIWI Airlines, Midwest Express, Northwest Airlines, Reeve Aleutian Airways, Southwest Airlines, Trans World Airlines, United Airlines, United Parcel Service, and USAir. ATA associate members include: Air Canada, Canadian Airlines International, and KLM-Royal Dutch Airlines.

Now, as many of our nation's industries are reporting record profits, the airline industry, which has not had a profit since 1989, is being hit with yet another tax -- a 4.3 cents per gallon fuel tax that is expected to cost the airlines more than $527 million annually. This new tax is in addition to the estimated $6.5 billion the airline industry pays annually in Federally-mandated taxes and fees. In addition to the 10% excise tax on airline tickets and a 6.25% excise tax on cargo shipments, airlines collect a $6.00 International Departure Tax, a $6.50 Customs User Fee, a $6.00 Immigration User Fee, a $1.45 Agricultural Inspection Fee and, at many airports, a $3.00 Passenger Facility Charge. These taxes and fees are in addition to the Federal and state income, local property, and other taxes which all businesses must pay.

Allow me to take a moment to illustrate the staggering increase in government-imposed taxes and fees during the past five years. In 1990, the Passenger Ticket Tax was increased from 8% to 10% as part of an overall deficit reduction package. The additional 2% was deposited directly into the general fund, not the Aviation Trust Fund, in both 1991 and 1992. The timing of this ticket tax increase, coming in the midst of a deep recession and increased fuel costs resulting from the Gulf War, came at the absolute worst time and added more than $1 billion a year to airline costs. (I would note that within twelve months of the imposition of this tax, nearly all of the bankruptcy petitions were filed and Pan Am, Eastern, and Midway Airlines ceased operations.) As a result, however, the airline industry has already made a special contribution of approximately $2 billion for Federal Budget deficit reduction.

As large as the 1990 ticket tax increase was, it is just one example of the many cost increases mandated by the Federal government during this difficult period. Listed below are examples of additional tax and fee burdens placed on the airlines during the past five years:

- 1990: As part of that same deficit reduction package, the cargo and waybill tax was increased from 5% to 6.25%. This tax cost our industry $326 million last year.
- 1990: Congress authorized the Passenger Facility Charge, which cost the airlines $851 million in 1994 alone, and more than $1.4 billion over the past three years.
- 1990: Congress authorized the Agricultural Inspection Fee, to which the airlines paid $63 million last year.
- 1993: Congress authorized an increase in the INS User Fee, from $5.00 to $6.00. This tax cost the industry $288 million last year.
- 1993: The Customs User Fee was increased from $5.00 to $6.50 to help pay for the North American Free Trade Agreement. This fee cost the airlines $295 million last year.

Ironically, with regard to NAFTA, airlines negotiate access to foreign countries through separate individual bilateral agreements. Aviation rights are not part of the NAFTA treaty, and NAFTA had absolutely no effect on U.S. carrier access to the Mexican market. Yet, airlines were asked to pay for the benefits others derive from NAFTA through this increased fee.

Madam Chairman and members of the Subcommittee, the taxes and fees listed above are only those which *increased* during the previous five years, and are in addition to those I mentioned previously. To target any single industry with such a plethora of new taxes -- as well as tax and fee increases -- at a time when cumulative industry losses total more than $13 billion would be almost comical, were it not true.

Three charts following my written testimony visually display the rapidly increasing excise taxes and user fees over recent years, as well as the strong relationship between airline losses and these rapidly increasing government-imposed taxes and fees during this same period.

You might ask, how does the airline industry compare to other transportation industries, such as the trucking and railroad industries, with regard to Federally-mandated fuel taxes? The commercial trucking industry pays a Federal tax of 18.4 cents per gallon for gasoline and 24.4 cents for diesel fuel, while the railroad industry pays a total of 6.9 cents per gallon for diesel fuel.

To put this into perspective, if the $6.5 billion the airline industry already pays annually in Federally-mandated excise taxes were instead assessed in the form of a transportation fuel tax on the fuel we buy in the U.S., our industry is effectively already paying an astonishing **52.5 cents per gallon tax!** Compare this to the commercial trucking industry's 24.4 cents, and the railroad industry's 6.9 cents per gallon. The airline industry in effect pays **115% more** than the trucking industry, and **661% more** than the railroad industry. This clearly demonstrates that the airline industry is already paying government-imposed taxes and fees well in excess of its fair share.

As John Dasburg, President and Chief Executive Officer of Northwest Airlines Corp. stated recently in an article published in the Wall Street Journal:

> **"It is not difficult to appreciate the impact of such significant [government imposed] cost increases on an industry that operates on thin margins of about 2% in its good years. These fees and taxes are not based on profits, but instead must be paid without regard to profit or loss. And because airlines price to demand rather than cost, these cost increases cannot be passed on to customers; the airlines must absorb them.**
>
> **The story of the airline industry in the '90s is a textbook example of the damage that ill-conceived tax policies can do to an industry."**

During our efforts to restrain government-imposed costs, we are repeatedly confronted with the assertion that carriers should simply pass on the additional costs of new and increased taxes by charging higher air fares. Stated simply, if this were possible, the industry would have done this long ago, rather than confront the numerous adverse consequences associated with losing an industry-wide $13 billion over five years. From an economic perspective, the culprit is price elasticity. Price elasticity of demand for air transportation measures the percent of change in air passenger demand in response to a 1% change in airline ticket price. Industry analysts and academicians have concluded that each 1% increase in airline ticket price results in a 1% *decrease* in passenger traffic. During the past few years of widespread industry losses, airlines simply have not been able to raise air fares to cover costs. In fact, carriers have been forced to lower their fares to attract customers.

The commercial airline industry is one of the most energy intensive industries in the United States, with fuel representing the second largest airline expense, next to labor. Consequently, the industry is extremely sensitive to increases in the price of fuel. Unfortunately, while the cost of fuel has been relatively stable over the past few years, the average price per gallon has begun to increase in recent months. Most analysts currently predict that prices are headed in an upward direction, with an average forecast increase of at least 8%, and possibly as high as 14%, during 1995. It should be noted that each one cent per gallon increase in the market price of fuel results in more than a $150 million increase in cost to the airline industry. For the government to increase our tax burden concurrently with an increase in the price of fuel would most certainly exacerbate the fragile airline industry recovery.

It has been nearly two years now since the Administration and Congress established the National Commission to Ensure a Strong Competitive Airline Industry. In the spring of 1993, the industry had just finished reporting what many termed "staggering losses," which at that time totaled almost $10 billion. When the Commission issued its final report to Congress and the Administration in August, 1993, one of its major conclusions was that the amount of taxes imposed on our industry has impeded our ability to return to financial health. The Commission stated:

> **"We believe those (tax) provisions violate responsible principles of common sense and good public policy and we are of the opinion changes must be made to relieve the airline industry's unfair tax burden."**

Ironically, while many in the new Congress clearly understand the industry's precarious financial situation, the Administration has yet to deal with this key aspect of the Commission's report -- the same Commission which the Administration pushed long and hard to create.

Testifying before the House Transportation and Infrastructure Subcommittee on Aviation in March of this year, Patrick Murphy, Acting Assistant Secretary of Transportation, the Administration's witness, reflected on testifying before that same committee two years prior:

"In 1992, the U.S. aviation industry suffered its worst year ever, with total operating losses of $2.2 billion and net losses of $4.6 billion... I am pleased to report that today's picture is different... The industry is now in a position to accommodate this tax increase."

Madam Chairman, if $10 billion in airline losses in 1993 is a problem, logic would have it that nearly $13 billion in cumulative losses two years later is an even larger one. Unfortunately, the Administration does not see it this way.

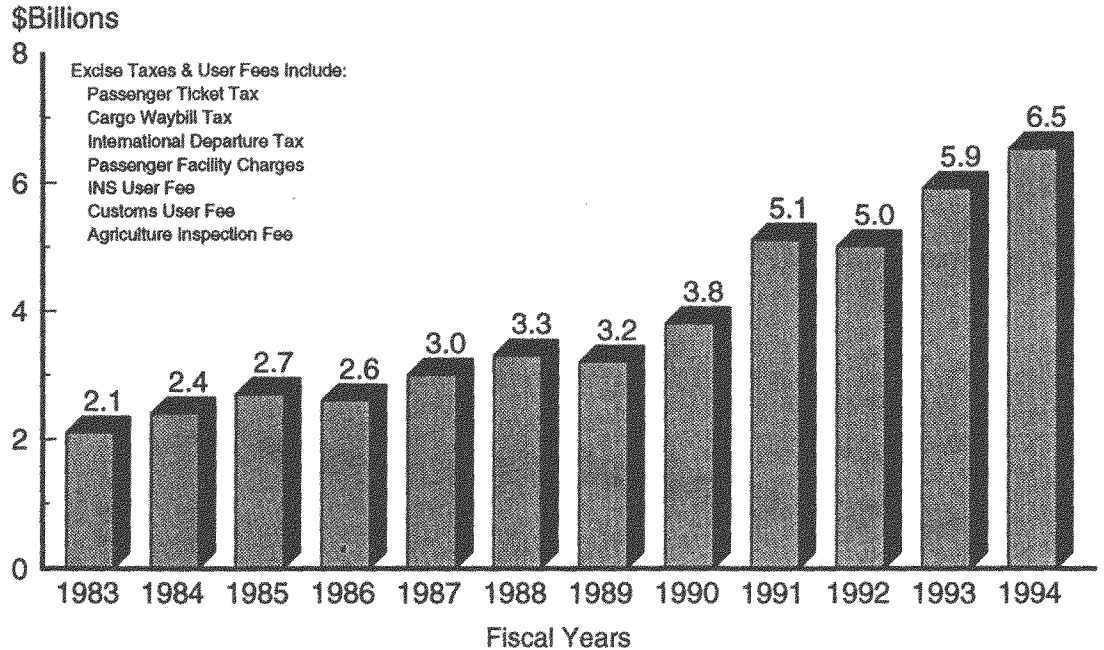
Fortunately, many in the new Congress understand with clarity the impact of a new half-billion dollar annual tax on an industry which has not made a profit since 1989. We are most grateful to you, Madam chairman, for allowing us to testify before you today. We are also very appreciative of Rep. Mac Collins (R-GA), and Rep. Jennifer Dunn (R-WA) for their strong support in sponsoring legislation, H.R. 752, to repeal the commercial aviation jet fuel tax, and to the 21 members of the Ways and Means Committee who are cosponsors of this bill. The industry is also extremely thankful to Chairman Shuster and the leadership of the House Transportation and Infrastructure Committee for their broad, bi-partisan support.

It is with these thoughts that we today urgently ask the Congress to continue this momentum and repeal the commercial aviation jet fuel tax. Repealing this tax is a necessary and critical step in creating an economic environment for a sustained airline industry recovery.

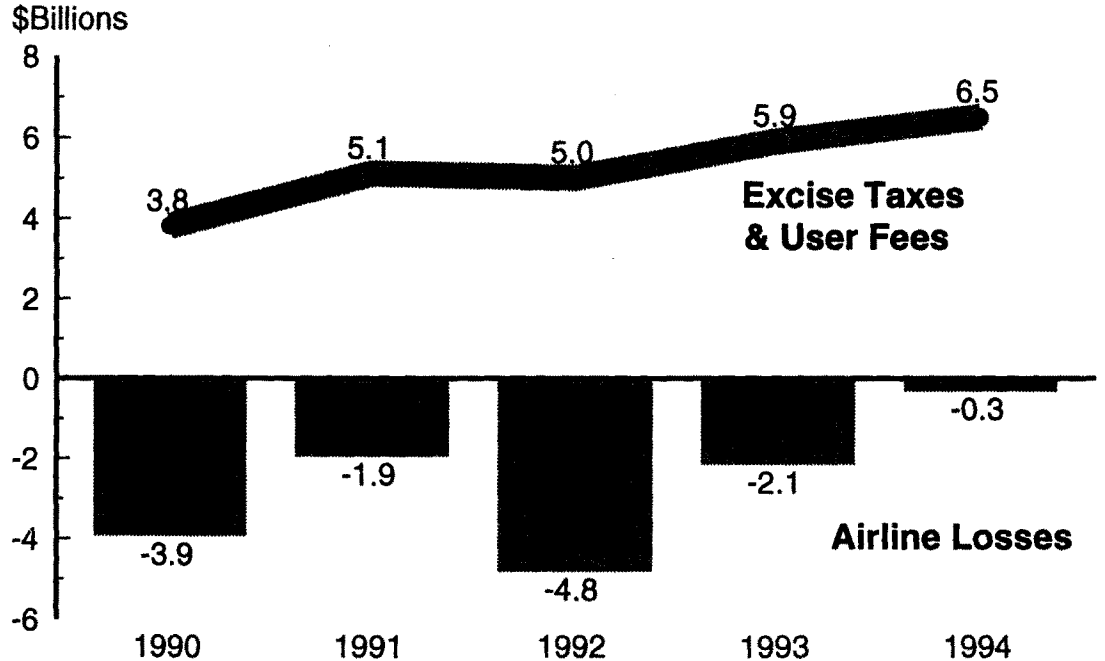
Let me close by quoting Daniel Webster, who stated nearly 175 years ago: "The power to tax is the power to destroy."

With that, Madam Chairman, I would be happy to answer any questions you or any member of the committee might have.

AIRLINE EXCISE TAXES & USER FEES RISING RAPIDLY



AIRLINE TAXES ARE RISING WHILE LOSSES CONTINUE



GOVERNMENT RELATED COSTS INCREASE FASTEST

	1988	1990	1992	1994*	ANNUAL PERCENT CHANGE
TRAFFIC & CAPACITY (Billions)					
Passenger Miles	312	325	334	345	0.9%
Available Seat Miles	508	536	533	536	1.7
Load Factor (%)	61.4	60.6	62.6	64.4	
REVENUES ($Billions)					
Yield (Cents)	12.2	13.2	12.7	13.3	1.5%
Passenger Revenue	38.1	42.9	42.2	45.7	3.2
Total Operating Revenue	42.2	47.5	46.7	51.1	3.4
EXPENSES ($Billions)					
Wages & Salaries	11.6	13.4	13.6	14.1	3.5%
Benefits	2.7	3.4	3.9	4.5	9.8
Fuel	5.7	8.6	6.6	5.8	0.2
Landing Fees	.7	.8	1.0	1.0	6.2
Passenger Food	1.4	1.7	1.8	1.6	2.4
Travel Agent Commissions	3.5	4.0	4.0	4.3	3.8
Maintenance	4.7	5.7	5.6	5.7	3.3
Advertising & Publicity	.9	1.0	.8	.7	(4.5)
All Other	9.1	10.6	11.2	11.9	4.6
Total Operating Exp	40.4	49.4	48.4	49.7	3.7
EXCISE TAXES ($Bill.)	3.189	3.701	4.759	6.190	12.2%

* 12 Months Ended Sep, 1994

Chairman JOHNSON. Thank you for your testimony.
Mr. Barclay.

STATEMENT OF CHARLES M. BARCLAY, PRESIDENT, AMERICAN ASSOCIATION OF AIRPORT EXECUTIVES AND FORMER MEMBER, NATIONAL COMMISSION TO ENSURE A STRONG COMPETITIVE AIRLINE INDUSTRY; ON BEHALF OF AIRPORTS COUNCIL INTERNATIONAL-NORTH AMERICA,

Mr. BARCLAY. Thank you, Madam Chairman.

I would like to submit my testimony and just make three brief points for the Committee.

In 1993, when the Airline Commission first got together, we asked some financial experts to come in and give us an overview of the industry, and the picture was startling even for those of us who thought we knew something about aviation. It was an industry that up to that point had lost in the preceding 3 years $10 billion. To put that in perspective, that is a larger loss than all the profits of all the airlines added together since the Wright Brothers flew.

The industry was a junk bond rated industry in its entirety, with the exception of Southwest Airlines. The major three carriers that were looked on as the strongest just a few years earlier had debt-to-equity ratios of 80 to 20 to 90 to 10. When the bankers who came in to testify before us said that they wanted to see balance sheets with 50 to 50 debt-to-equity ratios in order to loan money through normal channels to an industry like the airlines, and the airlines needed to borrow.

The last piece of this picture was an industry that needed to borrow $100 billion between 1993 and the year 2000 simply to meet the Federal noise rules for quieter aircraft and to re-equip the fleet even for the most modest projections of passenger growth.

As a result, the numbers simply did not add up and the people on the commission said, well, it also does not add up that we can run a modern economy without an airline industry in this country that at least has the financial wherewithal to attract enough capital to re-equip itself. The bar to look at is not bare profitability, it is can they make enough money to re-equip themselves.

As a result, among our 61 recommendations, we recommended that the fuel tax not go into place, that it was ill-advised at that time. Now that it is 1995, the picture has changed in that the airlines have lost $13 billion over the last 5 years, their balance sheets obviously have not improved, and they still have, according to Boeing, about an $80 billion need to invest in new aircraft between now and the year 2000. To impose this tax on the airlines in 1995 would be seriously illadvised.

The second point is that airport executives and operators are careful watchers of the airline industry. They are our partners, they are our tenants on our airports, and they are critical instruments of local economies in the communities where my members work. The airport industry is unanimous in its opinion that this ill-timed tax should not be levied on a struggling industry that is critical to our economy.

The final point I would like to make, Madam Chairman, is to ask the Members not to accept the argument, even if you are convinced on the merits of the case by the industry, you have to wake up the morning after the vote and say I did not want to do it, but the rules made me do it.

The BEA, Budget Enforcement Act, revenue offset rules have many good reasons for their existence. One of them cannot be, though, to damage a critical industry that our economy needs in the future, if we are to succeed.

Thanks very much. I would be happy to answer your questions.

[The prepared statement follows:]

STATEMENT OF CHARLES M. BARCLAY, A.A.A.
PRESIDENT, AMERICAN ASSOCIATION OF AIRPORT EXECUTIVES
ON BEHALF OF AMERICAN ASSOCIATION OF AIRPORT EXECUTIVES
AND AIRPORTS COUNCIL INTERNATIONAL-NORTH AMERICA

> "[W]e believe there are several tax provisions that impede the ability of the industry to return to financial health. We believe those provisions violate reasonable principles of common sense and good public policy and we are of the opinion changes must be made to relieve the airline industry's unfair tax burden."
>
> "Change, Challenge and Competition"
> August 1993 Report of the
> National Commission to Ensure a Strong
> Competitive Airline Industry

Madam Chairman and members of the subcommittee, my name is Charles Barclay. I am President of the American Association of Airport Executives (AAAE). I am appearing today on behalf of AAAE and the Airports Council International - North America (ACI-NA). AAAE is the professional organization representing men and women who manage primary, commercial service, reliever and general aviation airports which enplane 99 percent of the passengers in the United States. ACI-NA represents the local, state and regional governing bodies that own and operate commercial service airports in the United States, Canada and Bermuda. ACI-NA member airports serve more than 90 percent of the U.S. domestic scheduled air passenger and cargo traffic and virtually all U.S. scheduled international travel. I am also appearing today as a former member of the National Commission to Ensure a Strong Competitive Airline Industry.

We in the airport community are committed to making our nation's system of airports work efficiently, safely and economically. As such, we are keen students of our airline partners and follow with great interest all public policy issues which impact their financial health. I appear before you today to discuss the commercial aviation fuel tax

scheduled to be imposed on October 1, a government action which, if allowed to go into effect, will have severe adverse consequences on the airlines financial health as well as the financial health of airports.

Let me introduce this discussion by reviewing with you the state of play at the time the transportation fuels tax was enacted during the summer of 1993.

In the three preceding years, the airlines had lost a cumulative total of $10 billion. As a result of this terrible financial condition, Congress passed legislation to establish a National Commission to Ensure a Strong Competitive Airline Industry. I was honored to be selected to serve on the Commission.

The 4.3 cent per gallon transportation fuels tax was proposed in the Senate in June 1993, as a substitute revenue raising measure for the House-passed, broad based energy tax known as the BTU tax. Both the Btu tax and the ultimately enacted transportation fuels tax were part of an ambitious deficit reduction package. During its consideration of the transportation fuels tax, the Senate exempted commercial aviation in recognition of its financial weakness. Notwithstanding that determination, the joint House-Senate conference committee, searching for additional revenues to reach the targets which had been established, reduced the commercial aviation exemption to two-years.

In requesting that you prevent this new tax from going into effect, I suggest that you look at what has happened to the industry in the 21 months which have ensued since the adoption of the exemption and suggest that you do that in concert with a review of the Administration's response to the Commission's comments on tax policy headlined above.

In January 1994, the Administration released its "Initiative to Promote a Strong Competitive Aviation Industry" a response to the National Commission's work. Nowhere in that 23 page outline does the word "tax" appear. As a matter of fact, the Chair of the Council of Economic Advisors states in that document,

> "A strong economy will be the best medicine for what ails the aerospace complex. We believe that the recent budget reconciliation legislation, which reduces the deficit, along with other Administration initiatives, have put the economy on course for strong and sustainable growth."

So how has the "strong economy" affected the airline industry? For 1993, the industry lost $2.1 billion. For 1994, it looks like the industry will have lost another $100 million, thus bringing to five the consecutive years during which the airlines have lost money.

Bad as those results are, they do not reflect the impact of the commercial aviation fuel tax. On October 1, the imposition of this new tax will tap in excess of $500 million per year. Put another way, as the industry slowly lifts itself out of financial shambles, the fuel tax will siphon desperately needed cash from the industry, which is exactly what the National Commission articulated with reference to the fuel tax:

> "[A]t a time when the United States is looking for ways to strengthen the airline industry, an additional tax seems ill-advised."

Madam Chairman, that tax is as ill-advised today as it was in 1993. Two years after its initial consideration, the distressing economic situation which faced the industry continues. We agree that a healthy economy is a key component for airline industry profitability. Repealing the commercial aviation fuel tax is a necessary step in creating an economic environment for sustained industry recovery.

While my colleague from the carrier side, Mrs. Hallett, has spoken eloquently of the job losses in the airlines as well as the manufacturing sector, I would like to point to another potentially adverse aspect of this tax.

Airport infrastructure is financed by a blend of various user fees, such as the 10% excise tax on each ticket, Passenger Facility Charges, bonds, and fees levied on airport users, e.g. airlines and concessionaires. One of the steps airlines take when financially stressed, in addition to layoffs and deferring purchases of aircraft and engines, is to cut operating costs. To cut operating costs, carriers reduce frequencies, use smaller planes in certain localities, and pull out of marginal markets. While users pay for the airport infrastructure, it is in the marginal, smaller communities in greatest need of air service that are hit the hardest. The fuel tax increase would have the unfortunate unintended effect of penalizing marginal markets. In summary, airport executives and operators ask you not to impose this ill-timed tax on a struggling industry that clearly cannot afford it. Madam Chairman, I appreciate the opportunity to appear before you today. I will be pleased to respond to any questions you may have.

Chairman JOHNSON. Your last admonition is one we all feel keenly and we will do our best, but it is not possible simply to ignore the estimators in our work.

William Norman, please.

STATEMENT OF WILLIAM S. NORMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, TRAVEL INDUSTRY ASSOCIATION OF AMERICA; AND VICE CHAIRMAN, TRAVEL AND TOURISM GOVERNMENT AFFAIRS COUNCIL

Mr. NORMAN. Madam Chairman and Members of the Subcommittee, on behalf of the Nation's travel and tourism industry, I appreciate the opportunity to testify before you this morning. I ask that my full testimony be placed in the record.

I am here to express the travel and tourism industry's strong support for legislative proposals that would extend the exemption of jet fuel taxes as contained in the Omnibus Reconciliation Act of 1993.

I am William Norman, president and chief executive officer of the Travel Industry Association of America. I also serve as vice chairman of the Travel and Tourism Government Affairs Council, and it is on behalf of the council and its campaign to keep travel competitive that I appear before you today.

The U.S. travel and tourism industry generated an estimated $416 billion in expenditures in 1994, which equal more than 6 percent of the Nation's GNP, gross national product. Last year, travel and tourism was once again the Nation's leading export, generating $75 billion in expenditure from 44 million international visitors, and from the 46 million Americans traveling abroad who spent $53 billion, creating a $22 billion trade surplus.

Travel and tourism directly employs 6.2 million people and ranks second only to health care in employment. State and local communities are increasingly turning to travel and tourism to grow their economies, so much so that 34 States and the District of Columbia rank travel and tourism as one of their three top employers.

While the news about the size, scope and importance of travel and tourism for the Nation's economy is positive, some in public office have come to view the travel industry as nothing more than a tax generator and have constantly sought to increase our taxes and fees, which only hampers our ability to be jobs generators.

Our specific concern here this morning is the Federal jet fuel tax exemption which expires in October of this year. In 1993, Congress recognized that the airline industry had lost billions of dollars and had been forced to lay off tens of thousands of employees. Thus, airline jet fuel was exempted from the 4.3-cents-per-gallon increase and the Federal excise tax on motor fuel.

While the most dramatic and direct effect of applying this tax to aviation fuel would be on the airline themselves, such a fuel tax increase would also have an impact on other travel segments, such as hotels, restaurants, car rentals, amusement and attractions, as well as tour companies and others whose customers fly to their destinations.

Alarmingly, should continued price competition force the air carriers to absorb part or all of this increased fuel cost, it could further erode airline profitability, leading to additional airline layoffs

and a reduction in the number of flights, which would also harm the travel industry by offering business and leisure travelers fewer travel options, especially where there is no easy substitute for air travel. Fewer flights could lead to fewer passenger trips, resulting in reduced demand for lodging, meals, retail shopping, tours and attractions.

Madam Chairman, the travel and tourism industry has learned a valuable lesson concerning the corrosive effect of excessive taxation during the past year. For example, in 1990, the New York State Legislature approved a new 5-percent surtax on all hotel rooms costing more than $100 per night. Supporters of this higher tax projected the State to realize an additional $60 or $70 million annually, with few or no negative consequences.

To the surprise of no one in the travel and tourism industry, this higher tax had a dramatically negative impact, first and foremost on the lodging industry, but also on shops, restaurants, theaters and tour companies. Most of the negative effect was felt in New York City, where lower room occupancy rates forced hotels to lay off thousands of employees. Instead of collecting more tax revenues, New York actually lost millions of dollars, as business and leisure travelers went to lower cost destinations.

We recognize that other modes of transportation are paying the additional 4.3 cents per gallon for fuel. However, it is important to note that Congress has already mandated that airlines collect specific excise taxes in lieu of fuel taxes. The Federal Government is already collecting a 10-percent tax on airline tickets, as well as an array of other taxes and user fees, including a $3 passenger facility charge at many airports. This 10-percent tax on airline flights is already too high, and now the airline industry is threatened with even more taxes.

The travel and tourism industry strongly asks that the jet fuel tax exemption be extended, especially during this year of the White House Conference on Travel and Tourism. This year, as never before, our industry is focused on seeking new ways to grow and conduct business, generate more jobs, expand our export growth and provide even better travel experience for our customers. Higher taxes on the travel industry and its customers will only hamper our ability to achieve these goals and objectives.

Thank you very much, Madam Chairman.

[The prepared statement follows:]

STATEMENT OF WILLIAM S. NORMAN
PRESIDENT AND CEO, TRAVEL INDUSTRY ASSOCIATION OF AMERICA
AND VICE CHAIRMAN TRAVEL AND TOURISM GOVERNMENT AFFAIRS COUNCIL

Madame Chairman, on behalf of the nation's travel and tourism industry, I appreciate the opportunity to testify before you this morning. I am here to express the travel and tourism industry's strong support for legislative proposals that would extend the exemption for jet fuel taxes as contained in the Omnibus Reconciliation Act of 1993.

I am William Norman, President and CEO of the Travel Industry Association of America (TIA). TIA is the national, non-profit organization representing all components of the U.S. travel and tourism industry. I also serve as Vice Chairman of the Travel and Tourism Government Affairs Council, a coalition of 36 national associations, corporations and labor organizations. An affiliate of TIA, the Council is comprised of key elements of the travel and tourism industry, including all modes of transportation, accommodations, food service, travel agents, tour sales, recreation and attractions, as well as state and local travel and tourism officials. It is on behalf of the Council, and its *Campaign to Keep Travel Competitive*, that I appear before you today. A list of the Council's membership is attached to this statement.

Importance of Travel and Tourism

The U.S. travel and tourism industry generated an estimated $416 billion in expenditures in 1994, which equaled more than 6% of the GNP. Last year travel and tourism was once again the nation's leading export, generating $75 billion in expenditures from 44 international visitors while the 46 million Americans traveling abroad spent $53 billion...creating a $22 billion trade surplus, which accounts for 40 percent of the nation's total services trade surplus. Travel and tourism is the nation's third-largest retail industry, behind automotive dealers and food stores. It directly employs nearly 6.2 million people and ranks second only to health care in employment. The industry also supports another 5.8 million jobs through indirect and induced sales.

States and local communities are increasingly turning to travel and tourism to grow their economies -- so much so that thirty-four states and the District of Columbia rank travel and tourism as one of their top three employers. Travel and tourism jobs are rapidly increasing, with industry employment in the last ten years expanding at a rate more than twice that of the rest of the economy, and forecasters tell us travel and tourism employment will grow in excess of 30 percent over the next twelve years. Increasingly, these are top quality jobs, as more than 650,000 executive jobs exist in all segments of travel and tourism today.

Extending The Jet Fuel Tax Exemption

While the news about the size, scope and importance of travel and tourism for the nation's economy is positive, an insidious factor that has significantly threatened the growth and vitality of this industry is government-imposed taxes, fees and surcharges. Travel and tourism companies and their customers are willing to pay their fair share of taxes and fees -- and in 1994 travel and tourism generated $56 billion in tax revenue for Federal, state and local governments. Unfortunately, however, some in public office have come to view this industry as nothing more than a tax-generator and have constantly sought to increase our taxes and fees, which only hampers our ability to be a jobs-generator.

Our specific concern here this morning is the Federal jet fuel tax exemption, which expires in October of this year. In 1993, Congress recognized that the airline industry had lost billions of dollars and had been forced to lay off tens of thousands of employees. Thus, airline jet fuel was exempted from the 4.3 cent increase in the Federal excise tax on motor fuel. While the most dramatic and direct impact of applying this tax to aviation fuel would be on the airlines themselves, such a fuel tax increase would also have an impact on other travel segments such as hotels, restaurants, car rentals, amusements and attractions, as tour companies and others whose customers fly to their destinations, and hundreds of cities and dozens of states whose economies are dependent on travel and tourism.

Indirect impacts on other segments of travel and tourism from a new Federal tax on aviation fuel could come in at least two different ways. If the airlines choose to pass along the total fuel cost increase of more than $500 million annually to their customers through higher ticket prices, this

could result in greatly reduced demand for flying, which would impact all the other components of travel and tourism whose customers usually fly to reach those destinations.

On the other hand, should fierce price competition force the carriers to absorb part or all of this increased fuel cost, it could lead to additional layoffs at the air lines themselves, and a reduced number of flights, which would also harm the travel industry by offering business and leisure travelers far fewer travel options where there is no easy substitute for air travel. This could easily lead to fewer trips being taken and would lead to reduced demand for lodging, meals, retail shopping, tours and attractions.

The travel and tourism industry has learned a valuable lesson concerning the corrosive effect of excessive taxation during the past few years. In 1990, the New York State Legislature approved a new 5% surcharge that applied to all hotel rooms costing more than $100 per night. This money was to be used to help reduce the state's budget deficit. Supporters of this higher tax believed the state could realize an additional $60 or $70 million annually, and that there would be no negative consequences.

To the surprise of no one in the travel and tourism industry, this higher tax had a dramatically negative impact, first and foremost on the lodging industry, but also on shops, restaurants, theaters and tour companies. Most of the impact was felt in New York City, where lower room occupancy rates forced hotels to lay off thousands of employees. Meetings and convention business fell in excess of 30% over a four year period. Instead of collecting more in tax revenue, New York officials drove business and leisure travelers to less-taxed destinations and the State of New York actually lost millions of dollars in revenue. The hotel tax surcharge was finally repealed last year, but not before the damage was done to New York's travel and tourism economy.

In the case of New York's higher taxes, you could argue that travelers at least had other options for places to visit or conduct meetings. But, if a higher Federal tax is levied on jet fuel, there will be no way to avoid the tax; especially for longer trips that require air travel. And yes, fuel costs for other modes of transportation are paying the additional 4.3 cents per gallon for fuel, but Congress had already mandated that airlines collect specific excise taxes in lieu of a fuel tax. The Federal government is already collecting a 10% tax on airline tickets, as well as an array of other taxes and user fees, including a $3.00 passenger facility charge at many airports. This 10% Federal tax on airline flights is already too high, and now the airline industry is threatened with even more taxes.

Should Members of Congress seek further counsel on this issue, they need look no further than the final report issued by the *National Commission To Ensure A Strong Competitive Airline Industry* in early 1994. The National Airline Commission called on Congress to "relieve the airline industry of its unfair tax and user fee burden." The travel and tourism industry strongly agrees and asks that the jet fuel tax exemption be extended. Especially during this year of the White House Conference on Travel and Tourism, this industry is seeking new ways to grow, new innovative ways to conduct business and provide even better travel experiences for our customers. Higher taxes on the travel industry and its customers will only hamper our ability to be a leading jobs-producer.

TRAVEL AND TOURISM GOVERNMENT AFFAIRS COUNCIL
MEMBERSHIP

MEMBERS

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Airports Council International
American Automobile Association
American Car Rental Association
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American Society of Travel Agents
American Travel Affairs Council, Inc.
Association of Retail Travel Agents
Gray Line Worldwide
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International Association of Convention and Visitor Bureaus
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National Business Travel Association
National Council of Area and Regional Tourism Organizations
National Council of State Travel Directors
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Recreation Vehicle Industry Association
Society of American Travel Writers
Society of Travel Agents in Government
Travel Industry Association of America
US Tour Operators Association

MEMBERS AT LARGE

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Roger H. Ballou, American Express Travel Related Services Co., Inc.
Robert H. Dickinson, Carnival Cruise Lines, Inc.
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Edward P. Faberman, American Airlines, Inc.
Richard Fain, Royal Carribean Cruises, Ltd.
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Charles Gillett, New York Convention & Visitors Bureau
Judson Green, Walt Disney Attractions
Darryl Hartley-Leonard, Hyatt Hotels Corporation
Noel Irwin-Hentschel, AmericanTours International
Robert E. Juliano, Hotel Employees and Restaurant Employees International Union
William Tiefel, Marriott Lodging
Jonathan M. Tisch, Loews Hotels

Chairman JOHNSON. I thank the panel for your comments.

Mr. Barclay, you heard the testimony of Mr. Murphy of the Department of Transportation. He claims that Wall Street analysts share his outlook that the airline industry is in an increasingly strong position, because over the last few years they have made structural changes in their cost base that positioned them well. How do you respond to his testimony?

Mr. BARCLAY. I think there is a tremendous difference between analysts that might be looking at market timing and brief periods in which an industry may do better than they have done before and long-term profitability. This is an industry that the economy has got to have running adequately and efficiently, and the long-term picture is simply very bleak. No one would put their money—

Chairman JOHNSON. To be more specific, certainly capacity has dropped severely through the restructuring. That does make higher loads possible. I personally have experienced the cancellation of a flight that was at roughly the same time as another flight just to reduce cost, at some inconvenience to passengers. Certainly, there are improving revenue streams and there has been a restructuring of the financial obligations of the industry.

Reducing capacity and restructuring the financial base and renegotiating contracts, all those kinds of things have long-term outyear affects. I think you do have some responsibility to meet more aggressively the claim that some on Wall Street see you now as well positioned for the future. This is one of the fundamental differences between the two sets of testimony, what is the state of health of the industry. I think it is significant that the industry has restructured its cost base so extensively that it now feels free to engage in what I think are rather outrageous competitive fare wars.

Mr. BARCLAY. Well, there is no doubt that the horizon of the industry looks better because of the numbers Mr. Murphy was talking about that are operating profits. This is an industry that has built 50 billion dollars' worth of debt over this recent period that you have got to factor in, and that is why they have no net profit. The fact that they may be coming out and earning profits in Wall Street cycles is not the correct long-term picture to look at for the industry, in our view.

Chairman JOHNSON. Thank you.

Would anyone else care to comment?

Ms. HALLETT. Madam Chairman, I think it is very important to respond in a little more detail. Certainly it is true that you can get different analysts to give different projections. However, many of the administration's numbers refer to operating profits. This figure does not include interest costs or debt service, and we use in the industry net profit, which includes all of those costs.

Treasury and Mr. Murphy say that the FAA, Federal Aviation Administration, reports the industry had an operating profit of $2.6 billion and a net profit of $1.2 billion for the fiscal year 1994. I want to point out that this is truly an accounting sleight of hand, because fiscal year 1994 includes the last quarter of calendar year 1993, and that is the quarter in which both Continental and TWA emerged from bankruptcy and, therefore, all of their debt service costs were written off.

In addition to that, our figures, the ATA figures that we have received from the Department of Transportation say that the calendar year loss for 1994 was $285 million for our industry. That certainly does not even relate to what we have heard this morning. I might point out that the first quarter of this year, 1995, we have had a loss of $88 million for new profit loss for this quarter. We are just simply not talking from the same sheet of music, and I think it is very important to keep in mind that you have to talk in terms of net profit, or it just does not compute.

Chairman JOHNSON. I think your point is very well taken. Thank you.

Mr. Levin.

Mr. LEVIN. Just to follow up, I very much agree with Mrs. Johnson's comments. I think it would be helpful if you would zero in on this issue, the overall standing of the airline industry and also the amount of taxes and other assessments, whatever one wants to call them, that are borne by the industry as compared with other modes of transportation.

There is a need to be fair here across the transportation industry, and I think it is true that the notion was that the exclusion of aviation would be temporary. I would add that unless there was reason to make it permanent, and that is the issue. I do not think we can resolve this today, but I think you and Treasury and everybody else in the next days should try to boil down your argument.

I just want to emphasize the reason for this is it is not going to be easy to find these monies. We are truly in a budget crunch and we have held this separately from the deficit, but in the end I think this all going to be rolled together. I do not mean in terms of one legislative package necessarily, but we are going to have to look at all sources of income and all expenditures, and I think we should get away from the kind of caricatures on the one hand that you really have an easy cushion at the moment. That clearly is not true, or, on the other hand, that the government is just being unreasonable as to knee-jerking it. I do not think that is true.

We have a problem and we all have to be part of the solution. You heard us ask the agencies to supply us with an assessment of the tax shares of the respective parts of this critical industry, and I think you should give us your analysis of it, including your assessment of the present and longer term economic condition. Clearly, the airline industry is critical and we here have to know what we are doing. I think the Chairwoman would very much welcome your boiling this down, and so would I.

Ms. HALLETT. Thank you, Mr. Levin.

I appreciate your comments and certainly we will be happy to submit additional written testimony in response.

I would like to just reiterate comments that were made this morning by not only the Members of the Subcommittee, but also in testimony, and to reiterate that in the case of the transportation industry entities involved, it is important to point out that we are indeed paying $6.5 billion in taxes, and that is a variety of taxes, some of which goes into the Aviation Trust. We have not in any way shirked our responsibility to more than pay our fair share.

As Mr. Collins indicated, if you put all of these costs together, we are currently paying 52.5 cents per gallon in tax. If we add the 4.3 cents, that would then take us up another 4.3 cents over the 52, and it is just a matter of how can you continue to keep people employed and airlines in the sky. For every 1-percent increase in ticket prices, there is an automatic 1-percent decrease in passenger traffic, and this has been true over the many years. We would welcome the opportunity to submit some more information to you.

[The following was subsequently received:]

Air Transport Association

Carol B. Hallett
President & Chief Executive Officer

May 30, 1995

The Honorable Sander Levin
2230 Rayburn HOB
Washington, D.C. 20515

Dear Congressman Levin:

I appreciate the opportunity to respond to the question you posed to me during the Oversight Subcommittee hearing on the jet fuel tax waiver extension.

Effectively, you asked that I provide you with information demonstrating the relative tax burdens of the airlines, as compared to other segments of the transportation industry, and how the airlines have already contributed to deficit reduction despite losing over $13 billion over the last five years.

With respect to the relative tax burdens of the airline industry compared to other sectors of the transportation industry, I think it is necessary to look into the taxes paid by airlines which differ from those other transportation sectors as well as any of those taxes which compensate the government for services. In effect, all transportation companies pay income taxes, and I am not aware of any substantial differing treatment within the transportation sector in the computation of income taxes.

In addition to income taxes, various transportation sector modes pay user fees and excise taxes. According to the Congressional Research Service, airline user fees and excise taxes exceed those paid by the trucking and railroad sectors by 115% and 661%, respectively. In exchange for those taxes and user fees, the airlines receive certain government provided services. According to the Congressional Budget Office's most recent cost allocation study, airlines pay 113% of the cost to the government for the services provided. Since the carriers are anticipated to pay to the government $6.5 billion in user fees and excise taxes in 1995, that 13% surplus amounts to $845 million which is effectively our contribution towards balancing the budget.

In addition to the $845 million in excess of services which the carriers will pay in user fees and excise taxes in 1995, there is an existing uncommitted balance in the aviation trust fund of $4,890,941.03. Since 95% of the fees paid into the trust fund are derived from the airlines, the airlines have also already paid $4,401,846.90 to offset the deficit (95% of the uncommitted balance).

Clearly, the airline industry pays substantially more than its fair share. I am not aware of any other industry which is paying so much, in comparison to others in the sector. Nor, for that matter, am I aware of any industry which pays so much more than the cost of service and receives such mediocre quality service from the government.

I hope that this answers your question. If there is any further information I can provide, please don't hesitate to contact me.

Sincerely,

Carol Hallett

Carol B. Hallett
President & CEO

Mr. LEVIN. Good. We need to finish this, so I think this is going to be one of the most difficult decisions and it is kind of easy for us to even sign a bill. It is harder to enact it in this situation.

Let me put it this way, and then I will finish. If the excise tax had been considered today instead of a few years ago, I think it would have been much harder for the airlines industry to have been excluded. It was because it was in a clearly precarious position.

I think the issue has somewhat changed. It is in a better position and now we need to argue out, I hope on a bipartisan basis—there is no reason for anything else—why you should continue to be excluded from it. In order to do that, we have to look at the entire transportation industry and projections as to the continued health or lack of it in this vital industry. You need to help us, and we will argue this out and try to come to a rational conclusion.

Thank you very much.

Chairman JOHNSON. Thank you, Mr. Levin.

Mr. Collins, briefly.

Mr. COLLINS. Thank you, Madam Chairman. I will talk fast. That is impossible. [Laughter.]

You know, you looked pretty good, Mr. Levin, standing there yesterday with that muscle in your hand. I liked the comparison you did with the cost of it here versus the cost in Japan. You made a very good point there. Your point on the tax on the airline industry was not nearly as impressive, for whatever that is worth.

Mr. LEVIN. If you will yield—

Mr. COLLINS. I do not have much time. I have got to be brief.

Mr. LEVIN. I am not at all unsympathetic to your position. I just think we need to be hardheaded on everything.

Mr. COLLINS. I've got you.

Ms. Hallett, it has been mentioned here this morning that the cost of fuel for the aviation industry is at a low point. However, I understand it is beginning to rise some. Some people suggest that, with it at a low point, this would be the appropriate time to impose this tax, because it would not be felt near as hard by the industry. What is your position? What do you think about that statement?

Ms. HALLETT. First of all, Mr. Collins, I think it is important to point out that just this year we have already seen an increase in the first few months of this year 1995. As an example, we are always about 2 months behind in terms of a lag to tell you exactly what the cost is today versus 2 months ago. In February, the cost was 56 cents per gallon. Since that time, we have had a continuing increase. In fact, crude was 10 percent just very recently, and now we know that there is going to be an increase of between 8 and 14 percent for the entire year.

We have just received, in fact, a very interesting report and it is one in which the front page says jet fuel prices to soar in 1995 adding $4 billion to costs. While that is worldwide, that impact directly on U.S. carriers is going to be extremely difficult for us to handle, without having to either continue layoffs or obviously make fewer purchases of aircraft, which relates, of course, to a decrease in the number of employees with those companies, and it is a snowball effect.

I guess the most important point I could make is that for each 1-cent-per-gallon increase in taxes or in the cost of fuel, there is an automatic $150 million increase in costs to our industry. If we have that kind of cost increase for every 1-cent-per-gallon increase, then obviously I think the handwriting is on the wall. It is going to be a very difficult year. There will not be profits and we will not be able to continue to employ as many employees as we have right now.

Mr. COLLINS. I think that is very well put, Ms. Hallett.

I want to refer to one other thing that you just mentioned, and that is a continued cancellation or further reduction or stall off in purchasing of equipment. When you look at your balance sheet, you look for depreciation, interest and profit to cover the cost of indebtedness. Is that not a fair statement?

Ms. HALLETT. Absolutely.

Mr. COLLINS. The way you get a depreciation schedule or cost figure down is not to purchase, and it will gradually go down over the time this equipment is depreciated out. That is also prolonging the purchase and requiring airlines to operate older equipment in order to stall off the purchase of equipment to lower that depreciation factor and to lower the indebtedness that you are having to meet.

Mr. Barclay mentioned that by the year 2000, the industry is going to have to purchase $80 billion in equipment. Was that the figure I heard you say?

Mr. BARCLAY. The industry estimates it at $15 billion a year between now and the end of the century.

Mr. COLLINS. This is going to have a reverse effect on what you are doing by increasing depreciation cost, lowering the profit structure and increasing the indebtedness.

Ms. HALLETT. That is absolutely correct.

Mr. COLLINS. It is a falsehood for the Department of Transportation—and I do not know why the Department of Transportation is even engaged in this conversation. It seems like it should be between the Ways and Means Committee, Congress, and the Department of the Treasury, not the Department of Transportation. They are just supposed to be the regulatory agency and not a taxing agency. Needless to say, they were here with their bells on to denounce this bill. They are really shooting themselves in the foot in the long run with anticipated revenues based on their approach to this tax and other taxation.

We appreciate your comments. Thank you, Madam Chairman.

Chairman JOHNSON. Thank you.

There are two brief questions to which I would like your response. Is there any difference in how this tax would hit long-haul versus short-haul carriers?

Ms. HALLETT. Of course, it is simply based on the amount of fuel that is purchased. Obviously, it is the amount of fuel that is purchased and the amount of flights that are flown.

[The following was subsequently received:]

Air Transport Association

Carol B. Hallett
President & Chief Executive Officer

May 10, 1995

The Honorable Nancy L. Johnson
Chairman
Committee on Ways and Means
Subcommittee on Oversight
343 Cannon House Office Building
Washington, D.C. 20515

Dear Madam Chairman:

I would like to thank you once again for the opportunity to testify before your Subcommittee on the commercial aviation jet fuel tax which is scheduled to be imposed on October 1, 1995.

I very much appreciate your interest in this issue and would like to offer a bit of clarification on a question which you asked regarding the potential competitive implications of the tax between short-haul and long-haul carriers.

To the extent that a greater amount of fuel is burned during an aircraft's ascent to cruising altitude then during cruise, carriers with a higher frequency of short-haul service would incur increased fuel burn costs due to the fact that a greater percentage of their total flight time would be utilized for achieving ascent to cruising altitude. Thus, carriers having a higher percentage of short-haul flights will be impacted more by the imposition of the aviation jet fuel tax than long-haul carriers.

I hope this clarifies my response during the hearing. If you have any further questions, please let me know.

Sincerely,

Carol

Chairman JOHNSON. That seems like a logical answer to me. Someone suggested to me that there was a difference, and I wanted to be sure whether there was a difference or there was not a difference. I hear you saying there is not a difference, and that is logical and I accept it.

Could you also comment on why, when you have overcapacity, you need to buy new airplanes?

Ms. HALLETT. Among other things, Madam Chairman, we are confronted with a number of different problems that we are responding to, by buying new planes that are quieter, for instance. Of course, there was legislation passed by Congress around 1990 that required all aircraft, by the year 2000, to meet stage 3 aircraft requirements to be quieter than the stage 2 aircraft that were primarily flown at the time. That would have been the old 727s, 737s, and a variety of other aircraft.

Today—and Mr. Barclay made reference to this—today, those new aircraft that are being purchased, of course, meet the stage 3 requirements. It i s obviously beneficial. As an example, the Boeing 777, which is a two-engine aircraft, it has a much greater capacity than does maybe its sister, the 757, and, therefore you can carry more people and have fewer airplanes landing in lieu thereof.

What we are looking at is the need to provide greater capacity, while at the same time meeting government regulations of not only stage 3, which is going to cost, as was mentioned, some $15 billion a year in upgrading of equipment to meet these requirements. It is almost endless. I am beginning to sound like a broken record, because one thing leads to another, all of which leads to increased costs for our industry, and that is one of the reasons why this increase in the fuel tax would be so detrimental to not only our short-term, but our long-term ability to meet the needs of the people.

Chairman JOHNSON. Thank you very much. I appreciate your comments. Thank you for your participation today.

The next panel will consist of Bernard Zahren, president of Zahren Alternative Power Corp., in Avon, Connecticut; and Francis Barkofske, vice president, external affairs, Zeigler Coal Holding Co., in Illinois.

It is a special pleasure to welcome Mr. Zahren to this hearing, as he is one of the examples of the ingenuity and vitality of my district.

STATEMENT OF BERNARD J. ZAHREN, PRESIDENT, ZAHREN ALTERNATIVE POWER CORP., AVON, CONNECTICUT; ON BEHALF OF SOLID WASTE ASSOCIATION OF NORTH AMERICA

Mr. ZAHREN. Does your vitality carry through lunch?

It is a pleasure to be here this morning. I am representing the Solid Waste Association of North America, which has approximately 5,400 members and basically represents many of the municipal landfill operators in this country.

We are here in support of an extension of the section 29 incentive for alternative fuels as it applies to landfill gas. Landfill gas is that gas which is generated in a landfill through the natural decomposition of the organic materials in the landfill.

We believe that the section 29 credit is a viable alternative to what we consider a current unfunded Federal mandate to the mu-

nicipal level of the landfill industry. The comments made earlier by Treasury indicated that the section 29 credit was a stimulus passed in 1980 to help other types of fuels become economically viable. Most of those other fuels were eliminated from the section 29 in 1992 by the Congress. Most of those fuels were things such as Devonian shale, tight sands, coalbed methane, and so forth, which had to be explored for in order to be used.

Landfill gas is a little different. Landfill gas comes out of every landfill, whether we go after it or not, and it is a very, detrimental greenhouse gas. According to the EPA, Environmental Protection Agency, the methane content of landfill gas is approximately 22 times more harmful to the atmosphere and the greenhouse gas problem than carbon dioxide. Therefore, reduction of the methane emissions from landfills is a very strong priority for the current Administration's commitment to reduce greenhouse gases to 1990 levels by 2000, as well as the world ecological and environmental concerns.

In line with that, the EPA is about to come out with a set of regulations this August covering the new source performance standards under the Clean Air Act. In the estimation of the Federal Government, the EPA, there will be approximately 10 percent of the 6,000 landfills in the United States that are currently either active or in the process of closing that will have to comply.

By complying, they will have to put in a collection system, collect the landfill gas and dispose of it. Our estimate of that cost for approximately 600 landfills, which is 10 percent of the total, would be somewhere in the neighborhood of $1.5 billion. Therefore, we feel that, first of all, these NSPS standards will amount to an unfunded Federal mandate which is being passed on to local communities, and the only alternative, particularly for a municipally owned landfill, will be to pass on that cost to every citizen of that municipality that has their trash picked up and disposed of at the landfill.

How do we turn this into a positive? Well, instead of spending $1.5 billion to simply dispose of this gas and flare it off to get rid of it, which is the primary objective under the NSPS standards, we propose that these 600 and, in fact, as many as 700 to 800 of these sources of landfill gas could economically be developed as an alternative fuel.

I disagree with Treasury on the statement that we no longer need an incentive for alternative fuels. I think we are far from out of the woods on the energy crisis, and economic utilization of approximately 600 more landfills would save on the order of 27 million barrels of imported oil per year, if we can use this fuel instead of flaring it.

I also disagree with Treasury on the revenue neutral side of this picture. If, instead of spending $1.5 billion in unfunded mandates, which are simply costs that will have to be borne by local residents, we turn around and employ private capital to build an energy recovery system, the typical rule of thumb is that private developers such as myself will spend approximately three times the total that it would cost just to collect the gas.

Instead of $1.5 billion to simply collect and flare off the gas, we are talking a new capital investment by private industry of approximately $4.5 billion to recover and use this gas. By doing so, as an entrepreneur, I would look at a project and I would not even entertain entering into a project unless I could make something in the neighborhood of 10 percent or better on my capital investment.

If you work that equation out, 10 percent of a $4.5 billion investment, roughly $450 million a year in additional profits—I do not know exactly what you folks in Congress plan to do with the income tax structure—currently at 35 percent, but that would be a Federal tax of approximately $157 million. Our estimate of the total section 29 tax credits available for these same 600 landfills—and I believe Treasury and the EPA, Evironmental Protection Agency, would agree with this—is in the neighborhood of $100 to $130 million a year. That is based on a year 2000 baseline, given another 4 years to develop these additional landfills.

Therefore, we believe that the implementation of incentives to encourage development of landfill gas as an alternative fuel not only strongly supports the administration's commitment to the reduction of greenhouse gases and to the global environment, but also provides an opportunity to increase taxes which will exceed by a considerable amount the amount of taxes given back in the form of this credit.

It is also not possible usually to use 100 percent of this credit. There are things such as alternative minimum tax, and so forth, which do not allow a developer such as myself to fully utilize the credit. I would argue that this is more than revenue positive, if we can effectively utilize this gas as an alternative fuel. I believe that the current sentiment in Congress, while you are concerned about a balanced budget and revenue neutral items, is to also be concerned about the unfunded Federal mandates, and this is a very large one when it comes down to State, municipal, and local government entities that operate these landfills and also the private operators of landfills.

Therefore, we strongly support, if not an indefinite extension of this credit, at least a 4-year extension of the in-service date, which is now due to expire for projects that do not have a binding contract by December 31, 1995, and are not in service by December 31, 1996. If Congress does not act this year to extend this incentive, we believe development on many of these potential projects will grind to a halt by December 31 of this year.

Likewise, we are seeking an extension of the sunset date on the back end of the credit for at least a comparable number of years, in other words, to the year 2011—or, if permanent, that would be lovely, also—but some extension longer than 2 years for the in-service date and the sunset date is our wish list here this morning.

We do not agree with Treasury. We would be happy to provide them with our revenue estimates from new taxes projects, and to support any other positions that we have taken relative to why they should support this from the Clinton administration's viewpoint of supporting greenhouse gas emission reductions.

The EPA is spending a lot of money on what they call the EPA Methane Outreach Program, which is intended to get States, electric utilities, municipalities and private developers to all cooperate in the use of landfill gas to reduce this methane emissions problem. Without this incentive, I think those of us on the private side who are being called on to provide the capital will have to largely walk away from this potential opportunity. Therefore, we would urge you to consider an extension of the section 29 Federal tax credits.

Thank you.

[The prepared statement follows:]

Testimony of

Bernard J. Zahren
President
Zahren Alternative Power Corporation
appearing on behalf of
The Solid Waste Association of North America

before

Subcommittee on Oversight of
the Committee on Ways and Means

May 9, 1995

Madam Chairwoman, members of the committee, my name is Bernard Zahren.

I am president of Zahren Alternative Power Corporation. We are in the business of tapping methane gas at landfills and using it to generate electricity. ZAPCO has 11 such projects operating currently, making it the fourth largest landfill gas company in the country if one measures by number of projects in operation, but we are much smaller if the measure is the kilowatt hours of electricity produced. Our projects tend to be fairly small in size.

I am here today on behalf of the Solid Waste Association of North America. SWANA is an association for landfill owners and operators, as well as for other solid waste management professionals. Most members of the association are local government officials charged with disposing of solid waste. There is also a separate trade association -- the National Solid Waste Management Association -- for private landfill owners. Both associations are supporting the effort that brings me before this committee today.

SWANA strongly encourages the committee to extend the section 29 tax credit.

The section 29 tax credit is a credit that encourages people to look for fuel in unusual places. The credit was originally enacted in 1980, and it has been extended three times since then. The amount is adjusted each year for inflation. It was $5.76 for the equivalent of each barrel of oil that a taxpayer produces in alternative fuels in 1994. The figure for 1995 production won't be announced by the Internal Revenue Service until April next year.

The credit used to apply to a large number of alternative fuels, including gas from Devonian shale, tight sand formations, coal seams, geopressured brine and biomass, oil from shale or tar sands, and synthetic fuels from coal. However, the list was cut back to just two fuels the last time Congress extended the credit in 1992. The two that still qualify are "gas from biomass" and "synthetic fuels produced from coal." An example of "gas from biomass" is methane produced by decomposing garbage at landfills.

The idea was to get people to look in places for fuel that they would not look if left on their own. Thus, the credit phases out automatically if oil prices return to levels that make it economic to produce these fuels without the subsidy provided by the tax credit. The credit was not available for the first two years after it was enacted because oil prices were in this range.

There is a deadline for placing projects in service to qualify for the credit. Projects that produce the remaining two fuels still qualifying for tax credits must be in service by December next year.

We are asking Congress to extend this deadline for another four years through December 2000 for the two fuels that still qualify.

Projects that are in service by this deadline qualify for tax credits currently on the fuel they produce through 2007. This is the "expiration date" for the credit, as opposed to the deadline for placing projects in service. We are asking that this expiration date also be pushed back by four years.

It is important that Congress act this year to extend the credit before work grinds to a halt on projects that are under development as developers conclude there is too great a risk these projects won't be finished in time to place in service by December next year. Synthetic coal fuel projects have long lead times. Landfill gas projects have shorter lead times. Work will stop on many new projects well before the deadline at the end of next year unless Congress has taken steps to extend the credit. There is no sense in continuing to pour money into a project for which the credit is a necessary inducement if the project can't get into operation in time to qualify.

Why should Congress extend the credit?

Before I answer this question, please understand that what drove Congress to enact the section 29 credit in the first place in 1980 is not what has led it to extend it in the 1990's. The credit was originally part of a strategy for making the United States less dependent on imported oil. The Arab oil embargo was still fresh in people's minds. The country had just gone through not only painful energy

shortages, long lines at gasoline stations, inflation and high interest rates driven by spiralling prices for oil, but also a deep recession due to the high interest rates. Congress was determined that the country not be held hostage again to one side's interests in the Middle East conflict. It enacted a series of measures aimed at encouraging business to use energy more efficiently and at inducing business to rely more on renewable fuels -- like sunlight, wind, geothermal fluid and waste -- and to tap previously untapped resources for fuel. The section 29 tax credit was part of this strategy.

By 1992, the sense of urgency was gone. The logic for continuing the credit for many of the fuels covered was gone. Thus, Congress kept it only for two fuels -- basically landfill gas and synthetic fuels from coal. In the case of landfill gas, there is an unfunded mandates problem and there are important environmental reasons for continuing the credit. In the case of synthetic fuels from coal, the United States has tremendous coal reserves, but coal can be a dirty fuel and there was a desire to keep efforts underway to develop coal-based fuels as an alternative to burning straight coal.

SWANA's interest is landfill gas. Decomposing garbage produces methane. Methane is a potential health and safety hazard, as it will find an outlet from the landfill. The gas has two possible outlets. It can migrate underground to adjoining properties, where it kills or stunts vegetation by displacing oxygen from the ground. Alternatively, it can escape into the atmosphere. Contaminants in the gas contribute to air pollution and mix with sunlight to create smog. During the 1980's, there were more than two dozen life-threatening explosions and at least three deaths due to landfill gas accumulation in nearby structures.

Landfill owners take steps to control the gas either by installing "passive" systems, like trenches, barriers and vents to prevent gas from migrating underground and to give it an outlet into the atmosphere, or by installing "active" systems where the gas is pumped to the surface and either flared, vented, or collected for use as fuel.

Use as fuel is still infrequent. There are approximately 6,000 active and recently-closed landfills in the United States. At the end of 1990, gas was being collected for fuel at just 97. In 1995, the figure is still only 143.

Last year, the federal Environmental Protection Agency created a special Landfill Methane Outreach Program in an effort to encourage more collection of landfill gas for use as fuel. Methane is a greenhouse gas that contributes to global warming. It is the second largest contributor to global warming after carbon dioxide, and landfills are the single largest identified source of methane emissions,

accounting for more than a third of total methane released by the United States.

Greenhouse gases are expected to increase by 14.5% during the 1990's. The Clinton administration committed in April 1993 to hold greenhouse gas emissions to 1990 levels. The Landfill Methane Outreach Program is an effort to avert this increase. EPA is preparing a report to Congress on barriers to landfill gas projects, it has set up a hotline to cut through red tape, and it is in the process of signing cooperative agreements with states and utilities to encourage more landfill gas utilization.

Congress should extend the section 29 tax credit because there is unfinished business at the nation's landfills. Word about the credit was slow to get out. Most landfill owners have only recently become aware of it, and having become aware, the pace of landfill gas development is increasing noticeably. There was almost a 50% increase in landfill gas projects in the last five years. The credit needs more time to reach its potential.

EPA estimates that approximately 750 of the estimated 6,000 active and recently-closed landfills in the United States are candidates for landfill gas production. It won't happen without the credit.

Congress should also extend the credit because it is a reasonably low-cost response to the problem of unfunded mandates. From the standpoint of SWANA, most of whose members are local government officials, the federal government has imposed standards on landfill operations, but provided no money to implement them. The Environmental Protection Agency proposed "new source performance standards" for landfills in May 1991, and it has revised them twice since then. As currently proposed, the new standards would require any landfill with a design capacity or solid waste in place of at least 2.5 million metric tons, and whose nonmethane organic compound emissions are expected to exceed 50 metric tons a year, to install a control system.

The credit is an inducement to the private sector to do the municipality's work. We are opposed to dropping the credit but leaving the federal mandates in place.

The new source performance standards will not take effect until the federal government reissues them in final form. That is currently expected to occur in August, but they have been delayed a number of times, so the publication date may be delayed further. In the meantime, many landfill owners are unwilling to commit to landfill gas projects because they want to see what the final rules require. They are quickly backing up against a wall, since section 29 requires not only that landfill gas projects be in service by December next year to qualify for tax credits, but also that there be a binding contract for the project by the end of

this year. There isn't much time left for binding contracts, and if the rules are delayed again, there will no time at all.

Congress should also extend the credit because this is something tangible the United States can point to that it is doing to reduce greenhouse gas emissions that contribute to global warming. Let me read from an editorial in The Economist magazine from April 8, 1995.

> "Hyprocrisy is nothing new in international politics. But when the topic is global warming, the ability of governments to say one thing and do another is, let's say, breathtaking. As the Berlin climate-change summiteers waffled on this week, official delegations held countless press conferences proclaiming how worried their governments were that the accumulation of greenhouse gases could lead to catastrophe. At countless closed meetings, each country then refused to do anything much about it."

Rich countries committed in 1993 to reduce greenhouse gas emissions to 1990 levels by the year 2000. The Environmental Protection Agency has concluded it is impossible for the United States to meet this commitment without taking aggressive steps to encourage more landfill gas collection at landfills.

Cindy Jacobs, manager of the Landfill Methane Outreach Program at EPA, gave some interesting statistics in a talk last year. The Clinton administration is counting on 43% of the reductions in greenhouse gas to come from the efforts it is making through the Landfill Methane Outreach Program and its other "green programs." Methane accounts for 18% of total greenhouse gas emissions -- the second largest contributor to global warming after carbon dioxide. However, methane is about 20 times more effective than carbon dioxide in trapping heat in the atmosphere, so its contribution to global warming is far out of proportion to its percentage in the mix of total gases. Landfills are the largest identified source of methane in the United States, and the United States accounts for 35% of total landfill methane emissions worldwide.

Many air pollution officials -- not just at EPA but also at the state and local level -- would like to see the tax credit extended.

Finally, let me speak briefly to the economics of landfill gas projects and why most such projects won't be built without the tax credit. Landfill gas is more expensive to collect and use as fuel than to flare. Once collected, it is too impure and has too low an energy content to be put in pipelines and mixed with natural gas, so there is a limited market for it. The market is basically potential industrial consumers within a one- or two-mile radius of the landfill.

There often aren't any such people. Consequently, at most projects, the developer of the project will install electric generating equipment -- which adds to the cost -- to use the gas for generating electricity.

The electricity is sold to the local utility. Thus, in most projects, the source of revenue to cover the costs of the project is revenue from electricity sales. The developer needs about 5¢ to 6¢ per kilowatt hour from the utility in most cases to make the project economic. Utility "avoided costs" -- the amount that the utility is prepared to pay a wholesale supplier for electricity -- are in the 3 to 4¢ range in areas of the country where additional capacity is needed. They are roughly 2 to 2 1/2¢ a kilowatt hour in other areas. The developer might get a slightly higher average price from the utility under a long-term contract because of the way the escalators and capacity charges are calculated under such contracts. The tax credit is worth about 1¢ per kilowatt hour. The bottom line is that it is the difference currently between whether or not a project is economic.

In conclusion, Congress should extend the section 29 tax credit for the two fuels that qualify currently.

It should do this because there is still unfinished business at the nation's landfills, the credit is an inexpensive way of getting the private sector to do the municipalities' work in carrying out unfunded mandates involving landfills, and the credit is important to carrying through on the commitment the United States has made to reduce greenhouse gas emissions.

Chairman JOHNSON. Thank you.
Mr. Barkofske.

STATEMENT OF FRANCIS L. BARKOFSKE, VICE PRESIDENT, EXTERNAL AFFAIRS, ZEIGLER COAL HOLDING CO., FAIRVIEW HEIGHTS, ILLINOIS

Mr. BARKOFSKE. Thank you, Madam Chairman.

My name is Frank Barkofske. I am vice president of external affairs of Zeigler Coal Holding Co., an Illinois-based company, right outside of St. Louis, Missouri.

I have filed written testimony with the Committee in support of extending the deadline for synthetic fuels under section 29 for nonconventional fuels, the time period for which the facility should be put in production.

In the time alloted to me this afternoon, I would like to briefly describe two things, Madam Chairman. One is a project we have called the ENCOAL project, which has been qualified for the section 29 treatment, and the second briefly describes the importance of the project extending the deadlines.

My colleague to my left has already gone into section 29(c) and the time constraints. In order to save time, I would simply say we are under those same constraints as his biomass project is.

Our ENCOAL project is located adjacent to a coal mine in Wyoming. This is a project which is funded, 50 percent by the Department of Energy, and 50 percent by my company. It involves a total expenditure of approximately $90 million, of which DOE, the Department of Energy, is funding $45 million and we are funding $45 million.

It involves a new and advanced technology of converting low-rank coals; by low-rank coals, I mean those that have a great deal of moisture, a low heating value, and a relatively low sulfur coal, into a product of a higher heating value, and removing the moisture from it as well as reducing the sulfur in the coal.

Through a treatment process, the coal is actually chemically converted from one product, meaning the Powder River Basin coal—and by the way, this can also be used for lignite coal in Texas as well as in North Dakota, and we are in the testing stages of developing the same product for some of the Midwestern, higher sulfur coal.

Through a chemical process, the coal is dried, and then heated to a high temperature, and a liquid is then created, and is turned into a gas which is then cooled down, and results in a liquid fuel, very similar to a number six fuel oil.

The second component, which is the coal component, results in a coal product in where the BTU, the heating value, is raised from approximately 8,300 to over 11,000 BTUs.

The sulfur is reduced even further, from approximately 1.2 pounds of sulfur per billion BTUs, to 0.8 percent of sulfur per million BTUs. Approximately a 25-percent reduction in the sulfur of this already low-sulfur coal.

This has an application both to Wyoming coal, but it also has a benefit to other parts of the country. Under the Clean Air Act, as the Chairman is well aware of, the phase II compliance, which is

the year 2000, requires that coals be further reduced in their sulfur emissions.

This product, which is created by the ENCOAL process, is referred to in some places as supercompliance coal. It is going to overcomply, which means that other coals can then be blended in it, as well as being used to earn emission credits.

This is not simply a regional process. We are doing it in Wyoming because we have a coal mine there, and it is adjacent to it, and we have a fuel that is able to be used for the process. As I said, there are other projects around the country.

For instance, we are currently in discussions with ALCOA for a project in Rockdale, Texas, next to their lignite mine, in which they will use this for their power purposes in their aluminum plant.

We feel that we are simply on the cutting edge of this, and that it would be a mistake to cut off a project. We cannot market a commercial size project of this time with its status of section 29(c). With the expiring tax credit, we are finding that investors will not put in the $200 to $400 million required for a commercial size plant.

We think this would be a mistake, to stop a program that should be commercially adaptable, that is, environmentally doing what it should do, and as well as the section 29 purpose, to have independent fuels being developed so that our energy needs are met by our own coals, and our own energy fuels.

The last point I would like to make, Madam Chairman, is the AMT, alternative minimum tax. Alternative minimum taxpayers cannot presently take advantage of section 29 credits.

Zeigler happens to be an alternative minimum taxpayer. We are finding that many of the people who would invest in the commercial program are also not able to take advantage of it.

I commend this Committee for having recommended that the AMT tax be eliminated as of January 1, 2000. However, because of the time constraints, we do not believe that is going to help our commercial project, because already, people are beginning to wonder whether or not this credit is going to be available.

If they cannot take it now, the year 2000 is going to be too late. We would ask also, that the Committee consider eliminating that as a preference for this type of a project.

[The prepared statement follows:]

TESTIMONY OF
FRANCIS L. BARKOFSKE, VICE PRESIDENT - EXTERNAL AFFAIRS
ZEIGLER COAL HOLDING COMPANY
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
ON THE
PRODUCTION TAX CREDIT FOR NONCONVENTIONAL FUELS

MAY 9, 1995

Madame Chairman and members of the subcommittee, I am pleased to appear before you today to discuss the value of the production tax credit for nonconventional fuels. My name is Frank Barkofske, Vice President for External Affairs for Zeigler Coal Holding Company. Zeigler Coal is an Illinois-based company with its headquarters in Fairview Heights, just east of St. Louis, Missouri.

I am here today to testify in support of extending the placed in service date under Code section 29(g)(1) from January 1, 1997 to January 1, 2000, and eliminating the binding contract deadline of January 1, 1996 for synthetic fuels produced from coal. These dates were set in the 1992 Energy Act.

Section 29 tax credits are available as incentives to clean coal facilities for coal-derived clean fuels that are sold before January 1, 2008. However, under current law, these credits are available only if the qualified fuels are produced in facilities placed in service before January 1, 1997 and if there is a binding contract for such a facility entered into before January 1, 1996.

THE ENCOAL PROJECT

ENCOAL Corporation, which is owned by a subsidiary of Zeigler Coal Holding Company, has built and is now operating a first-of-its-kind coal upgrading plant near Gillette, Wyoming. Using a new and advanced technology called Liquids-from-Coal (LFC), the plant is capable of converting up to 1,000 tons per day of low-rank Powder River Basin coals into low-sulfur, high-quality solid and liquid fuels.

Low-rank coals abound in the Powder River Basin and throughout much of the West. While low in sulfur, these coals tend to have high moisture levels and lower heating values than most eastern U.S. coals. The LFC process subjects the coal to significant changes in chemical composition and removes moisture to produce higher quality fuels.

In the LFC process, coal is dried and heated so that part of the coal is converted to a gas. The gaseous vapors are cleaned and cooled, then condensed to form a liquid that can be used as an industrial fuel. This liquid also has potential as a feedstock for transportation and the production of chemicals. A low-sulfur, clean-burning solid fuel is also produced which has a higher heating value than the raw coal and has up to 25 percent of the sulfur content removed. We have tested the LFC process on other coals and have found it equally effective in raising the heating value and removing sulfur content.

The technological breakthrough represented by the LFC process will make the synthetic coal particularly attractive for power-generating companies that must reduce sulfur dioxide emissions to comply with the 1990 Clean Air Act Amendments. Currently, the technology has been successfully tested on Alaskan Lignite, Powder River Basin Subbituminous, Dakota Lignite, and Texas Lignite. Current possibilities for commercial facilities related to the ENCOAL project include Triton's Buckskin Mine near Gillette, Wyoming and Zeigler's properties near Rockdale, Texas.

In the case of the ENCOAL project, royalty revenue for the U.S. government could be as high as $45 million.

The ENCOAL project is one of the most successful projects in the Department of Energy's Clean Coal Technology program. The Department of Energy and ENCOAL entered into a cooperative agreement in September of 1990. DOE and ENCOAL are equally sharing the project's cost of $90 million. As part of that agreement, the DOE stands to receive royalties from the licensing of the ENCOAL process equal to an amount up to the $45 million federal expenditure. DOE authorized a final installment on the ENCOAL project in September 1994.

SECTION 29--AN INCENTIVE FOR "NON-CONVENTIONAL" FUELS DEVELOPMENT

In 1980, following the second major oil shock in seven years, the Congress enacted section 29 tax credits. Section 29 was intended to provide incentives for the production of alternative (or non-conventional fuels). Section 29(c)(1)(C) provides incentives to promote the construction of facilities that produce new, synthetic fuels from coal. Billions of dollars have been invested in these projects by private sector companies and the federal government over the past decade to develop and demonstrate new coal based alternative fuel technologies.

LARGE CAPITAL REQUIREMENT DELAYS MAKE DEADLINES UNREALISTIC

Zeigler Coal and other companies that have invested millions of dollars in promising new clean coal technologies will not be able to meet these deadlines. In some cases, these dates are unrealistic due to extraordinary up-front capital investment and expenditure requirements. Uncertain returns require extensive market analysis by potential investors. In addition, investors are unlikely to invest in "risky" clean coal technology projects that are not projected to deliver consistently above average returns on the investment. It is important that returns on investment match the risk involved in new technologies. Building a commercial sized clean coal plant could require an investment of up to $400 to $500 million. This level of investment will only happen if risks are minimized. The section 29 credit is intended to get new clean coal technologies off the ground by minimizing such risks.

CLEAN COAL COMMERCIALIZATION REQUIRES LONG LEAD TIMES

The long lead times needed for plant planning and construction make these deadlines unrealistic. It is often difficult to quickly meet all federal, state, and local permitting and regulatory requirements in order to build a major industrial plant. It is especially difficult for the coal industry to quickly meet permitting and regulatory requirements because of environmental, worker safety, and other related concerns. Construction of clean coal plants can often be delayed due to logistical and technical obstacles. Many coal mines, which are likely locations for clean coal plant construction, are located in remote areas with limited access to building materials. In short, materials delayed at any point during the transportation process can hold up construction. Assembling and fine-tuning new clean coal technologies can also lead to delays.

RECENT IRS ACTION INHIBITS USE OF SECTION 29

Stability in the tax system is also important. For example, one obstacle to meeting the current deadlines for some companies can be directly attributed to a recent IRS action. The Internal Revenue Service raised uncertainty for Zeigler Coal and other companies due to a recent series of private letter rulings withdrawing eligibility for section 29 credits from several coal companies. As Kennecott has outlined in it's testimony, 100 people lost their jobs due to the uncertainty caused by a delay

related to the IRS withdrawal of private letter action. Potential investors in Zeigler Coal's clean coal technology project were also given cause for concern due to this action.

The IRS issued a private letter ruling (PL8836071) on June 17, 1988 to Shell Mining Company (which owned the ENCOAL project at that time) in which they ruled that the synthetic fuels derived from coal are qualified fuels under section 29(c)(1)(C) of the Internal Revenue Code. On February 14, 1995, the IRS issued a withdrawal of the private letter ruling, effectively disqualifying the synthetic fuels produced from coal at Zeigler Coal's ENCOAL plant. Zeigler Coal immediately requested that the service reconsider its withdrawal of the 1988 ruling under which ENCOAL had already made commitments and expenditures of nearly $45 million. I am pleased to report that last week we received notice that the IRS had reconsidered its withdrawal and has now reinstated its 1988 ruling. It is my understanding that other companies also had their private letter ruling withdrawn and, after appealing the IRS action, had the withdrawal rescinded.

Despite these obstacles to advancing new clean coal technology projects, Zeigler Coal and other companies would like to move beyond the demonstration phase to the commercial phase.

CLEAN COAL TECHNOLOGY HELPS MEET PHASE II OF THE CLEAN AIR ACT

Advancing clean coal technology from the demonstration phase to the commercialization phase will help meet the mandated goals for Phase II of the Clean Air Act. Coal is the primary and most abundant energy source in the United States. Over fifty-seven percent of electricity is produced from coal. In 1990, Congress amended the Clean Air Act to require reduced sulfur emissions and other pollutants from coal-burning power plants. Phase I facilities (110 power plants) began their reductions on January 1, 1995 and all plants must be in compliance by the Phase II date, January 1, 2000. Utilities and industry were expected by Congress to make widespread use of alternative clean fuels produced from coal to help achieve these reductions. Clean coal projects can help the power generation industry meet Phase II of the Clean Air Act.

THE ALTERNATIVE MINIMUM TAX IS A BARRIER TO ADVANCING "NONCONVENTIONAL FUELS" TO COMMERCIALIZATION

I would like to commend the Committee on Ways and Means for reporting a bill to the House floor to repeal the alternative minimum tax (AMT). Companies interested in acquiring a license to use the ENCOAL coal synthesizing process in their operations are often AMT payers. Unfortunately for Zeigler Coal, currently an AMT payer, the repeal date does not come soon enough to spur the commercialization of the ENCOAL project. In short, we would like to have the section 29 credit available as an offset against AMT liability prior to the year 2000. Without this relief, Zeigler is unlikely to build another plant to synthesize coal into cleaner liquid and solid fuels.

The AMT undermines U.S. "non-conventional" fuels tax and clean coal appropriations policy. The government has provided Section 29 tax credits to encourage the development of alternative fuel sources. However, companies engaging in a "good faith" clean coal technology partnership with the government are discouraged from advancing the most successful projects to commercial use due to the inability of AMT paying companies to offset the credit against AMT liability. This contradiction in policies does not make sense. If the advancement of clean coal technology is good energy and environment policy for regular taxpayers to undertake, it is good policy for AMT payers to undertake as well. The intent of the AMT is to ensure all companies pay some tax. The AMT is not intended to undermine U.S. energy and environment policy. We would like you to consider further AMT relief as of January 1, 1996 for new clean coal technologies, as a supplement to the extension.

CONCLUSION

Madame Chairman and members of the subcommittee, I want to thank you for the opportunity to testify before you today. Zeigler Coal strongly supports the extension of the "placed in service" requirement for synthetic fuels derived from coal from January 1, 1997 to January 1, 2000 and repeal of the binding contract clause. I hope that my testimony has provided you with the information you need to offer this recommendation as part of a second tax bill this year. Thank you.

Chairman JOHNSON. I thank you for your testimony. It is interesting that in both the technologies that you talk about, one of the pressures that you are responding to are changes in Federal law to achieve environmental goals, that at the time we passed the law setting those goals, we did not have the technology to achieve them.

Around here, we call it technology pressing law, and you are the technology we press.

Mr. BARKOFSKE. And we can now put it into effect.

Chairman JOHNSON. It is interesting that there is a response, and with some very favorable spinoff. However, in your cases, and in the cases of others who have talked to us about this law, who are not currently covered by it, the issue really is not so much development of technology. It is really operating subsidies until you get big enough to be able to capitalize your own development.

That is a little different issue than keeping these credits in place throughout the life of the program that is needed to achieve compliance by the year 2000.

I would ask you to get back to us about what kinds of things we might look at to more directly tailor this support system, to, in a sense, the shorter term issue of creating the volume of demand that would allow you to commercialize the technology in a way that it is self-supporting.

It does not seem to me that that is a 5-year project. It seems to me that that is less than 5 years. And I am not saying that so much from my knowledge of landfill issues, or clean coal technology, as I am from some other approaches that are also interested in this.

That basically, they have a product, they have a technology that meets a very real need, but if they could lower their production costs for the product, they would be a big market competitor.

They cannot lower their production costs until they increase their volume. They cannot increase their volume until they lower their production costs. There is a place for government to help new technologies to get, in a sense, commercialized and viable, by subsidizing them through that period of volume growth.

At some point with the number of landfills that you mentioned, Bernie, and the timeframe within which States and local governments need to comply, I mean, there is clearly a demand.

What is that really essential need, that allows this demand to be met in a way that lowers the cost for local and State government because you have a viable product out there?

Mr. ZAHREN. We have a viable product from a technology standpoint, if you are going to make electric power, which is the predominant use of landfill gas today. Of 150 or so projects that are in production, using landfill gas, over 100 of them make electric power. The rest simply send the gas to a nearby boiler unit of some sort.

If we are to develop the 600 additional landfills, it is my belief that we will not be able to make electric power at most of those sites, and that is due to another Federal initiative which is currently underway, which I believe in, and that is the deregulation of the electric utility industry.

The FERC, Federal Energy Regulatory Commission, has just come out with a proposed major new set of regulations that will unbundle the transmission and the generation of electric power. Because of all of this, none of the utilities are anxious to buy our power today at rates that will allow us to be competitive.

Most of my 11 projects make power for 5- to 6-cents-per-kilowatt hour. Go back to our home State and ask Northeast Utilities what they will pay for power today. It is 2.6 cents.

I cannot make additional projects work at that kind of power rate. We do not have a need for a subsidy to make up the difference in electric rates, but a need for, indeed, R&D, research and development, to find new markets for the gas. I believe those markets will be in vehicle fuel, which is developing quickly, and results from another Federal set of mandates for the nonattainment air pollution areas, to convert fleets of over 20 vehicles to operate on an alternative fuel.

That can be done in the form of liquified natural gas, compressed natural gas, methanol, and potentially other products, all of which can be manufactured from the methane contained in a landfill.

I can not do that in the next 24 months, because the technology is largely unproven and undemonstrated. I can make electric power tomorrow, but I'm not building any more projects because I can't get the electric power contract.

I think the utilization of the gas is very dependent on new and different technologies for the use of the gas, which will take more than a year or two to implement.

Chairman JOHNSON. Thank you. That is very interesting. You see your market changing, and so actually this is the development credit for you?

Mr. ZAHREN. It is development; yes.

Chairman JOHNSON. Well, if you think about timeframes, that would be helpful to us.

Do you care to make a comment, Mr. Barkofske?

Mr. BARKOFSKE. Yes, I would, Madam Chairman.

Let me just say that our demonstration plan, which is the plant I described out in Wyoming, has proved itself.

The DOE considers it one of the flagships in their clean coal technology programs, and I think there is going to be filed in the record a copy of a letter from the DOE on the project.

We have a good project which is meeting the needs of clean coal technology, environmentally superior, and is domestic energy. The trouble we are having is to interest someone to build that first commercial plant, which is a $200 to $400 million expenditure.

We are finding that they are telling us, and we believe it because we would do the same thing—that without this section 29 tax credit, at least to the year 2008, as provided for in current law, the risk factor involved on this, the need to invest the capital is such that they have better needs for their money.

We believe that if we get one commercial plant going during this time period, then the economics of that process will carry itself.

So we are not asking—while my colleague indicated it would be nice to continue these credits forever, we are not seeking that from this Committee.

We are simply saying that we cannot meet the January 1, 1996, deadline for a binding contract, and the January 1, 1997 deadline for a plant in service for this size of an operation.

We are not asking for any additional help on our demonstration plant. We are simply saying let's go into the year 2000, which coincides with phase II of the Clean Air Act, to allow us to market this concept, and to get someone such as, hopefully, ALCOA, to put in a project like this, and definitely prove that on a commercial size it will make sense.

Chairman JOHNSON. Are you saying, then, that really, all you need is the time to get one project up and running under section 29?

Mr. BARKOFSKE. Yes, ma'am. I think that conceptually, since you are looking at 2 to 3 years for finishing a project, that is what we are looking at in the time phase of January 1, 2000. If it cannot carry its load after that, then I agree with some comments that have been made, that, it ought to fall by the wayside.

We do not think it will. We think this is a good project, and we have just run out of time to market it on a commercial size.

The DOE under our agreement, has a chance, once we license one of these plants, to begin to recoup the $45 million that they have expended for the project. Whether they will get it all back or not, I do not know, but there will be a revenue-raising aspect in it.

It is one of these things, that you see the light out there, it is not too far out there, and you are reaching for it, and we just cannot make it, Madam Chairman, and we are asking for Congress' help to extend the deadline.

Chairman JOHNSON. Once you build this plant, then you have an obligation to repay some of the DOE moneys?

Mr. BARKOFSKE. Our obligation is based on any licensing fee we have for this project, they get a certain percentage of it, up to the amount they have expended. Yes, ma'am.

Chairman JOHNSON. Perhaps you could give us a little more detail on that agreement, so that we could see that mechanism more clearly.

[The following was subsequently received:]

Department of Energy
Washington, DC 20585

The Honorable J. Dennis Hastert
U. S. House of Representatives
Washington, D.C. 20515-1314

Dear Congressman Hastert:

This is in response to your letter of March 30, 1995, requesting an evaluation of the success and commercial viability of the ENCOAL Clean Coal project as well as whether the Federal Government will be repaid as a result of the recoupment provisions in the associated Cooperative Agreement.

The ENCOAL plant began operations (production of coal fuels) in May 1994. It is producing both a low-sulfur, coal-derived liquid fuel (CDL) similar in quality to a low-sulfur No. 6 fuel oil and the second is a solid, process derived high-Btu fuel (PDF).

Process operating variations are still under study to identify ways to improve the stability of the solid product. ENCOAL has demonstrated that the PDF can be transported in rail cars by shipping it to Muscatine Power & Water in eastern Iowa under a thin blanket of Powder River Basin coal. This technique produced a blend which was successfully test burned in December 1994. A report on all commercial testing of both liquid and solid products will be issued in the near future.

The technical achievements to date support the participants in their belief that the project has a high success potential. The number of major utilities requesting ENCOAL's products for blending purposes, has increased markedly since the plant started operation.

The participant projects that PDF can be sold at a market price (on an equivalent energy content basis) normally expected for low sulfur eastern bituminous coal without any government support and/or credits. CDL product prices are dependent on the volatility of the oil sector, and PDF prices to the energy sector. The commercial economics remain to be confirmed, however, and the data from the extended operating period are factors essential to that assessment.

If brought to commercial viability, the ENCOAL project will help serve U.S. energy interests and enhance opportunities for economic growth. In addition, the project will help ensure a sustainable environment through the development of new technology. In short, the ENCOAL project has earned my strong support and is an excellent example of a successful public/private sector partnership.

You also asked about the recoupment of the federal government's investment of $45 million. If the ENCOAL project is not brought to commercial viability, the government will not recoup it's investment. However, if the project were to be licensed commercially, the federal government could receive royalties up to the $45 million public investment.

The Comprehensive Report to Congress, issued in June 1990, is enclosed. Meanwhile if we can be of assistance in any other way, please contact us.

Very truly yours,

Patricia Fry Godley
Assistant Secretary
for Fossil Energy

Enclosure

REPAYMENT AGREEMENT

ARTICLE I — GENERAL OBJECTIVE

The purpose of this agreement is to set forth the terms and conditions under which ENCOAL Corporation (defined herein as the Participant) shall repay to the United States Department of Energy (DOE) an amount up to (i.e., not to exceed) the Government's share of total project costs paid under Cooperative Agreement No. DE-FC21-90MC27339.

ARTICLE II — DEFINITIONS

"Contracting Officer" means the DOE official authorized to execute awards, financial agreements, and amendments thereto on behalf of DOE and who is responsible for administering this Repayment Agreement.

"Cooperative Agreement" means the financial assistance award made by the United States Department of Energy (DOE) to the Participant, Instrument Number DE-FC21-90MC27339 on _____ 1990 and subsequent amendments.

"DOE" means the United States Department of Energy and any successor department or agency.

"DOE share" means the portion of the total project costs paid by DOE under the Cooperative Agreement.

"Government" means the government of the United States, including DOE.

"Licensing Contractor" means the TEK-KOL partner designated under the TEK-KOL Partnership Agreement to undertake the primary licensing and development activities relating to the commercialization of the Demonstrated Technology.

"Participant" means ENCOAL Corporation and its successors and assigns.

"Project" means the set of activities described in Article XI (Allowable Pre-Award Costs) and in Attachment A, Statement of Work, of the Cooperative Agreement.

"SMC" means Shell Mining Company.

"TEK-KOL" means the California General Partnership between SGI International, a Utah corporation with offices in La Jolla, California, and SMC, the developers of the LFC Technology. TEK-KOL has entered into an Agreement of even date herewith to develop and commercialize the Demonstrated Technology on behalf of the Participant.

"Total project costs" means the total amount of allowable direct and indirect costs incurred by the Participant and paid, in part, by DOE under the Cooperative Agreement.

"United States" means any of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, and any territory or possession of the United States.

ARTICLE III — TERM OF THIS REPAYMENT AGREEMENT

This Repayment Agreement shall become effective on the date specified in the Cooperative Agreement as the end of Phase III (Operation) or as may be extended by any subsequent contract modifications, except that if the Participant unilaterally withdraws or terminates its participation under the Cooperative Agreement, this Repayment Agreement shall become effective on the date the Cooperative Agreement is terminated. This Repayment Agreement shall expire 20 years from its effective date or on the date the entire DOE share has been repaid, whichever occurs first. This Repayment Agreement may be terminated upon a determination by the Secretary of Energy or designee that repayment places the Participant at a competitive disadvantage in domestic or international markets.

ARTICLE IV — DEMONSTRATION TECHNOLOGY

(A) Demonstration Technology

For purposes of this Repayment Agreement, the "Demonstration Technology" shall consist of the mild gasification process based on the Liquids-from-Coal (LFC) Technology developed by TEK-KOL. The process involves deep drying and heating coal under carefully controlled conditions causing chemical changes in the coal. The chemical changes result from decomposition or pyrolysis of the coal producing gases and solid residue. The solids are further processed and stabilized producing a new fuel form, Process Derived Fuel (PDF). The gases are cooled and partially condensed, forming a second new fuel form called Coal Derived Liquid (CDL). The remaining residue gases are burned in the process for heat. Collectively, the licensable Demonstration Technology consists of everything inside the Technology Envelope as more fully described in APPENDIX 1 to this Agreement.

(B) Technology Rights

ENCOAL represents that is has obtained from SMC sufficient rights in the patented and unpatented technology, including copyrighted works and operating expertise, to enable ENCOAL to fulfill its obligations under the Repayment Agreement.

ARTICLE V — AMOUNT OF REPAYMENT

(A) The amount of the Participant's repayment obligation shall be based only on the sale, lease, or licensing of the Demonstration Technology, as defined in Article IV, in applications and for use at facilities located in the United States. The amount of repayment shall be 5 percent of the gross revenues from the sum of all royalties and licensing fees during

commercialization of the Demonstration Technology. Equipment sales/leases are not a revenue producing activity for the Participant and do not contribute to repayment.

For purposes of determining the amount of repayment, commercialization shall be deemed to have begun on the effective date of this Repayment Agreement or the day after commissioning of the first full scale commercial plant using the Demonstration Technology, whichever occurs later.

(B) License Fees

The Participant shall pay DOE an amount equal to 5 percent of the gross revenues from the aggregate license fees paid to ENCOAL, TEK-KOL, or any authorized licensor of TEK-KOL for use of the Demonstrated LFC Technology. In its License Agreement with TEK-KOL, the Participant requires that TEK-KOL include in all contracts or agreements with any entity which acquires the right to license the use of the Demonstrated LFC Technology, a provision requiring that all such license and sublicenses and associated revenues be reported on an annual basis to TEK-KOL. SMC and TEK-KOL have agreed to commercialize the Demonstration Technology on behalf of ENCOAL. TEK-KOL's agreement with the Participant includes an obligation to report all of this information to the Participant. The address of TEK-KOL's representative is as follows:

TEK-KOL Partnership
3366 N. Torrey Pines Court #220
La Jolla, CA 92037
Ph. (617) 452-0841

(C) Commercialization and Repayment Guarantee

SMC Performance Guarantee on behalf of ENCOAL for commercialization and repayment are included in Attachment A to this Repayment Agreement.

ARTICLE VI — SCHEDULE OF REPAYMENTS

Payments to DOE shall be calculated on an annual basis, and shall be due within 60 days after each 1-year period following the effective date of this Repayment Agreement.

ARTICLE VII — REPORTING AND RECORD RETENTION REQUIREMENTS

(A) Annual Report to DOE

Within 60 days after the end of each 1-year period, the Participant shall submit a written report to DOE which, for the 1-year period just elapsed, provides the applicable data described below:

(1) The total dollar amount of license fees and royalties paid for use of the Demonstration Technology;

(2) Quantities and descriptions of Demonstration Technology transactions under which license fees were paid;

(3) The total amount of revenue reported by each entity identified in ARTICLE V.

(4) The total amount owed and paid to DOE, and the amount of the DOE share remaining to be paid in succeeding years under this Repayment Agreement.

(B) Period of Retention

With respect to each annual report to DOE, the Participant shall retain, and shall contractually require TEK-KOL to retain, for the period of time prescribed in this paragraph, all related financial records, supporting documents, statistical records, and any other records the Participant reasonably considers to be pertinent to this Repayment Agreement. The period of required retention shall be from the date each such record is created or received by the Participant and TEK-KOL until 3 years after one of the following dates, whichever is earlier: the date the related annual report is received by DOE; or the date this Repayment Agreement expires or the final payment to DOE is received. If any claim, litigation, negotiation, investigation, audit, or other action involving the records starts before the expiration of the 3-year retention period, the Participant and TEK-KOL shall retain the records until such action is completed and all related issues are resolved, or until the end of the 3-year retention period, whichever is later. The Participant shall not be required to retain any records which have been transmitted to DOE by the Participant.

(C) Authorized Copies

Copies made by microfilm, photocopying, or similar methods may be substituted for original records. Records originally created by computer may be retained on an electronic medium, provided such medium is "read only" or is protected in such a manner that the electronic record can be authenticated as an original record.

(D) Access to Records

DOE and the Comptroller General of the United States, or any of their authorized representatives, shall have the right of access to any books, documents, papers, or other records (including those on electronic media) which are pertinent to this Repayment Agreement. The purpose of

such access is limited to the making of audits, examinations, excerpts, and transcripts. The right of access described in this paragraph shall last as long as the Participant retains records which are pertinent to this Repayment Agreement.

(E) Restrictions on Public Disclosure

The Federal Freedom of Information Act (5 U.S.C. § 552) does not apply to records the Participant is required to retain by the terms of this Repayment Agreement. Unless otherwise required by law or a court of competent jurisdiction, the Participant shall not be required to disclose such records to the public.

(F) Flow Down of Records Retention and Access Requirements

In any contract or other agreement subject to the reporting requirements described in Article V, Sections A and B, the Participant shall include clauses substantially similar to the records retention and access requirements set forth in sections (B) and (D) of this Article.

Evidence of Recipient Acceptance		Awarded By	
E. C. Summer	6-26-90		
Signature	Date	Signature	Date
E.C. Summer			
(Name)		(Name)	
President			
(Title)		(Title)	

Mr. BARKOFSKE. I will be glad to file that with—

Chairman JOHNSON. As you can tell from the preceding discussion, there are concerns about evenhandedness of public policy, and there are those who believe that this credit gives you all an unfair advantage against other sources of fuel.

Do you care to comment on that? I would by happy to hear your comments.

Mr. BARKOFSKE. Right now? Later, Madam, or right now?

Chairman JOHNSON. Yes. Right now.

Mr. BARKOFSKE. Oh, good.

We do not think the tax credit will unduly give advantage to this product. What it is doing is it is making an alternative available for people who want to have a supercompliance coal out there, that is able to be shipped across the country at reasonable rates, and burned in their power plant.

It is not going to, in any way, undercut any of the existing fuels. It simply gives the potential buyer for a utility, or an industrial complex, the advantage of being able to use an alternative source.

I would be silly if I stood here and said that it is going to be able to compete day in and day out with any of the other power plant sources.

If I might take just 1 minute. Let's take the ALCOA for example. Their aluminum plant is in Texas. We have lignite reserves adjacent to that plant. They also own and control some of those.

By putting the ENCOAL plant in between the lignite deposit and their aluminum plant, they would be able to avoid a processing step which is otherwise required in bringing that lignite into it. It is an ideal situation, it is one of those unique situations that the environment has improved, and once again, we are able to use a domestic source of power. That is just one instance of where it fits in.

This is not going to be a massive situation. I do not think anybody thought the clean coal technology projects were going to replace natural gas or coal.

We have over a billion tons of coal in our company, so we are not looking to replace all that. It simply fills a niche that we believe is out there, and that would bring to fruition this government program.

We have encouraged government, and company participation. This was a 50/50 deal between our company and the DOE, and we want to see it come to fruition.

Chairman JOHNSON. Thank you.

Mr. ZAHREN. I would also say the same thing with regard to landfill gas. Landfill gas contains approximately 50 percent of the methane content in natural gas. In order to clean it up and make it competitive with natural gas, for any use, whether it be in a boiler or as vehicle fuel, or to make electric power, what you have, is an expensive process.

Much of that technology is not proven yet. We have quotes from a number of chemical engineering firms, in the neighborhood of $1.5 to $2 per million BTUs for the cleanup cost of making landfill gas comparable to natural gas.

The amount of the credit today is 99-cents-per-million BTUs. That hardly makes us competitive with natural gas on a straight-

up basis, if it costs $1.50 to just clean the gas up, to be able to bring it to the point where it is even comparable to natural gas.

I would assume your economics are similar.

Mr. BARKOFSKE. Yes.

Mr. ZAHREN. It is not making us more competitive than conventional fuels. It is only subsidizing a part of the difference between the two.

Chairman JOHNSON. Thank you very much. I appreciate the quality of your testimony, and I appreciate this opportunity. It is too bad C–SPAN is not recording this kind of a hearing, because it gives people a lot more insight, I think, as we discuss each of these credits, as to the critical role that the Federal Government does play, and continues to play in both supporting troubled industries through hard times, and initiating creative responses to problems we face in the environment, or elsewhere, and responding to the educational needs of our people.

Thank you very much for your testimony, and with that, we will go to the next panel.

Mr. BARKOFSKE. Thank you very much, Madam Chairman.

Mr. ZAHREN. Thank you.

Chairman JOHNSON. Thank you.

Janet Tully, the director of community employment and training of Marriott International; Shepard Bailey, the director of tax, Pizza Hut; John Wright, president of Wright Foods of McAllen, Texas, on behalf of the National Restaurant Association; and Dave Edwards, vice president, associate relations, the A&P.

Janet Tully, would you proceed, please.

STATEMENT OF JANET M. TULLY, DIRECTOR OF COMMUNITY EMPLOYMENT AND TRAINING, MARRIOTT INTERNATIONAL, INC., WASHINGTON, DC; ON BEHALF OF THE COMMITTEE FOR EMPLOYMENT OPPORTUNITIES

Ms. TULLY. I am pleased to testify today on behalf of both Marriott International and the Committee for Employment Opportunities. My printed statement describes our group and the list of employers in it.

We have been working for months to seek remedies to cure the ills of the old TJTC, Targeted Job Tax Credit Program. Frankly, I was a little surprised at Mr. Ross' comments this morning because it dealt mostly with the old program, and we have all been working very hard, and we did speak with him about some of the new things that we are planning.

We are committed to a fundamentally changed model of the TJTC. We want everyone to look past the timeworn letters of TJTC and see the whole new concept.

I have managed TJTC for Marriott since 1979, so I have known this program inside and out, in all its incarnations. Please believe me when I say that the new Houghton-Rangel model would totally alter the focus of the employer in the most basic ways.

This fresh concept deals with the main criticism of TJTC head on. Would we hire those workers anyway?

The Houghton-Rangel model puts this matter to rest. All TJTC-eligible job applicants are preidentified by employers, and therefore, given extra consideration.

The new law would require that employers prescreen applicants to determine probable eligibility prior to the job offer, as part of the application process.

This kind of levels the playingfield. We are all looking for the best applicants for the job. Most TJTC-eligible folks are not going to be in that category.

By knowing that this person is TJTC-eligible, it will give them some preferential treatment, and they will be considered equally in the interview process.

Marriott welcomes that change. We hire over 50,000 workers a year, and upon passage of this bill we are planning to change all of our application forms.

TJTC prescreening questions will be printed on the first page, to make sure that this section is completed before the main application.

Most of the employers in the office of the CEO are planning to do the same thing. It will not be possible for us to issue a memo saying TJTC is back, it is business as usual. We, and all employers, will have to retrain all hiring managers regarding TJTC.

This will significantly change our hiring practices. At Marriott, our managers in the past always did seek TJTC-eligible people. We do outreach to different community-based organizations. We put job orders into the local job service. We work with the local disability organizations, and we have a lot of programs that were set up under this.

This will just increase our participation, once this renewal is passed.

The new Houghton-Rangel model would also encourage retention of these workers. We agree with Secretary Reich and Mr. Ross, that the credit can be backloaded to encourage employers to retain workers, provided that there is enough up front credit to offset the extra training costs.

The new TJTC would provide this backloading. In regard to retention, incidentally, the Treasury has expressed concern that some employers might let workers go after 1 year when they are no longer TJTC-eligible.

To be perfectly honest, I cannot imagine that an employer would deliberately turn over an experienced employee. Why would we, after spending 12 months training, coaching and counseling employees, deliberately let them go, just to start from scratch with a new, low-skilled, inexperienced TJTC worker? This makes no sense, and it is definitely not good business.

Training, coaching, and counseling. I cannot overemphasize how much costly time and effort is involved in hiring and keeping TJTC workers. This is why the credit has to offset the initial costs. The majority of TJTC-eligible people are folks who have little or no work history, minimal education, and minimal skills.

Many of these folks have not experienced much success in their lives. They expect to fail, and in many cases that is a self-fulfilling prophecy.

On occasion, our managers have even supplied new hires with alarm clocks so that they can get up on time. It did not seem to follow a logical path. They just said I did not wake up in time, and that is why they were late for work.

This experience teaches them the basic life skills that most of us take for granted.

One of the common causes for termination is excessive absenteeism. No call, no show, is a big problem. Coaching and counseling, and sitting down and explaining to these people how important it is for them to show up for work, and how, if you have a headache, that is not an acceptable excuse for not coming into work; how just missing a bus is not going to be an excuse.

If you are consistently late, it is not because the bus came early; it is because you did not leave your house on time.

We have to sit and work with these people, and spend a lot of extra time coaching them, in order to make them successful employees.

Without an incentive to offset the up front costs in doing this, most managers would not spend the time required.

Like most employers, Marriott credits the wage cost to the unit level. The logic is that even though a person may not be a 100 percent at first, at least with the credit it is not costing the unit the full wage.

We endorse the Houghton-Rangel model, which is user friendly, easily understood, reduces government administration, and it uses more objective eligibility standards.

Most importantly, the model fundamentally changes the focus of the program, gives a leg up to TJTC applicants, and fosters outreach to persons with barriers to employment.

That is my central message. I just want to comment on a couple of things that Mr. Ross spoke about this morning, and showed some of his concerns, and to show that we have addressed them.

One of his concerns was that we limit the potential for abuse of the program by targeting it on the truly disadvantaged.

This new program does target on the truly disadvantaged. It has more objective criteria, and focuses on persons eligible for means tested or public assistance programs.

Students on Pell grants, you are not going to find many Harvard graduates who went through on any Pell grants, are truly disadvantaged, and that is going to handle some of the abuse in the youth category.

They want to say that we should reduce the employer windfall. The new program addresses this concern with the prescreening. Of course, we need the blessing of EEOC, the Equal Employment Opportunity Commission, to make sure we are able to do that.

This is something that we would not have minded doing in the past, except for those concerned. I really believe that the employers are, in prescreening, going to make sure that they more than target the TJTC-eligible folk.

Improve the incentive to provide long-lasting jobs. I feel in backloading the credit we are going to make sure that that happens.

Thank you very much.

[The prepared statement and attachment follow:]

STATEMENT BY
JANET M. TULLY, MARRIOTT INTERNATIONAL
ON TARGETED JOBS TAX CREDIT
FOR
THE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS

May 9, 1995

I am pleased to testify for both Marriott International and the Committee for Employment Opportunities. My printed statement describes our broad coalition of employers, associations and public interest groups. We have been working for months to seek remedies to cure the ills in the old TJTC program. We're committed to a **fundamentally changed model.** We want everyone to look past those timeworn letters **"TJTC"** and see a whole new concept. The old program was a job opportunities model. It allowed employers to hire first, then screen for eligibility based mainly on family income. The new model, based on a different core principle, moving people from welfare to work by encouraging employers to seek out, pre-identify, hire and **retain** people who currently or potentially depend on public assistance and turning them into productive taxpayers. **The focus has changed.** The new program focuses the hiring manager's attention on the eligible job applicant before the hiring decision is made. It focuses the supervisor's attention on integrating the new worker into the mainstream workplace. And it focuses the employer's attention on retaining the worker as the size of the credit increases over time.

I've managed TJTC for Marriott since 1979, so I've known this program in all its incarnations. Please believe me when I say that the new Houghton-Rangel model would **totally alter the focus of the employer in the most basic ways.**

This fresh concept deals with the main criticism of TJTC head-on---would we have hired these workers anyway? the Houghton-Rangel model puts this matter to rest: **All TJTC-eligible job applicants are pre-identified by employers and therefore given extra consideration. The new law would require that employers pre-screen applicants to determine probable eligibility prior to the job offer as part of the application process.**

Marriott will welcome this change. We hire over 50,000 workers a year, and upon passage of this bill we are planning changes to all of our application forms. TJTC pre-screening questions will be printed on the first page to make sure that this section is completed before the main application.

It won't be possible for us to issue a memo saying "TJTC is back, it's business as usual." We and all employers will have to retrain all hiring managers regarding TJTC. This will significantly change our hiring practices

The new Houghton-Rangel model would also encourage retention of these workers. We agree with Secretary Reich that the credit can be backloaded to encourage employers to retain workers, provided that there is enough upfront credit to offset the extra training costs. The New TJTC would provide a 35

percent credit for the first six months of wages, and 45 percent in the second six months, and that is adequate.

In regard to retention, incidentally, Treasury has expressed concern that some employers might let workers go after a year when they're no longer TJTC-eligible. To be perfectly honest, I can't imagine that employers would deliberately turn over experienced employees. Why would we, after spending 12 months training, coaching and counseling employees, deliberately let them go, just to start from scratch with a new, low-skilled, inexperienced TJTC worker? This makes no sense.

Training, coaching, counseling: I can't overemphasize how much costly time and effort is involved in hiring and keeping TJTC workers. This is why the credit has to offset the initial costs. The majority of TJTC-eligible people are folks who have little or no work history, minimal education, and minimal skills. Many of these folks have not experienced much success in their lives. They expect to fail, and in many cases that's a self-fulfilling prophecy. On occasion, our managers have supplied new hires with alarm clocks so that they can get up on time. This experience teaches them basic life skills that most of us take for granted. They have to learn that their behaviors affect their co-workers and their company, not only themselves. Dependability is a very important skill, which can be learned only on the job. If you don't show up for your shift, everyone has to work harder, to cover for you. You have to learn how to accept criticism, to learn that your supervisor is only trying to help you, not put you down. Lessons like these take time to learn, and they require skill and patience to teach.

Without an incentive to offset the upfront costs in doing this, most managers would not spend the time required. Like most employers, Marriott credits the wage cost to the unit level. The logic is that even though a person may not be 100 percent productive at first, at least with the credit it is not costing the unit the full wage.

We endorse the Houghton-Rangel model, which is user-friendly, easily understood, reduces government administration, and it uses more objective eligibility standards. But most importantly, the model fundamentally changes the focus of the program, gives a leg up to TJTC eligible applicants and fosters outreach to persons with barriers to employment, and that is my central message.

COMMITTEE FOR EMPLOYMENT OPPORTUNITIES

Supporting Organizations

Corporations

A & P

ARA Service, Inc.

Burger King

Circle K

Dayton Hudson Corporation

General Mills

JC Penney

Kelly Services

Kmart Corporation

Manor Care, Inc.

Marriott corporation

May Dept. Stores

McDonald's

Montgomery Ward

Pepsico/KFC/Pizza Hut/Taco Bell

Southland Corporation

Wendy's International

Trade Associations

American Hotel & Motel Assn.

Associated Builders & Contractors

Food Marketing Institute

National Assn. of Convenience Stores

National Council of Chain Restaurants

National Restaurant Association

National Retail Federation

National Employment Opportunities

Network (NEON)

TJTC Coalition

Chairman JOHNSON. Thank you for your excellent testimony. Something has happened to the lights. They are very useful because they do help to give us warning, and if the staff could start the light system, that would be helpful.

Mr. Bailey.

STATEMENT OF H. SHEPARD BAILEY, DIRECTOR OF TAX, PIZZA HUT, INC.; ON BEHALF OF THE NATIONAL COUNCIL OF CHAIN RESTAURANTS

Mr. BAILEY. Good afternoon, Madam Chairman. My name is Shepard Bailey. I am the director of tax at Pizza Hut, Inc., based in Wichita, Kansas, and I am here today on behalf of the National Council of Chain Restaurants in support of the enactment of a permanent targeted jobs tax credit.

Before I begin my presentation on Pizza Hut's past experiences with TJTC, I would like to emphasize that Pizza Hut is one of the largest employers of individuals from the groups targeted by the former TJTC Program.

As such, Pizza Hut is well aware of the concerns that have been raised with respect to certain aspects of the program, as well as the manner in which it was used by some employers, or consultants.

Pizza Hut, as well as Pepsico, Inc., through its other restaurant divisions, have been involved with other employers in providing recommendations to Congressmen Houghton and Rangel, of ways to develop an employer tax credit that would address these concerns.

Pizza Hut commends Congressmen Houghton and Rangel for developing the draft legislation you have before you today, and we look forward to working with these congressmen, as well as you, the Members of this subcommittee, to enact this important legislation.

TJTC is an effective and efficient hiring incentive. Since 1990, Pizza Hut has provided job opportunities to over 30,000 TJTC-eligible applicants. These job opportunities represent the all important first steps for inexperienced workers to acquire the most basic skills absolutely necessary to advance in today's competitive job market.

For the 5-year period just ended, Pizza Hut has experienced a compounded annual growth rate in TJTC hires of over 20 percent.

Pizza Hut is committed to finding new and innovative ways to reach out to individuals who might not otherwise have job opportunities made available to them.

One program, Jobs Plus, designed to seek out, accommodate, employ and train persons with disabilities in every Pizza Hut unit, is a clear example of how TJTC is used to achieve its intended result.

This initiative has allowed over 13,000 persons with severe disabilities to become productive members of our work force.

Today, due in large part to Jobs Plus, Pizza Hut is heralded as the Nation's leading employer of persons with severe disabilities.

As for many employers presently using TJTC, the tax credit provided by TJTC was an important factor in Pizza Hut starting the Jobs Plus Program.

Now we all know that today's marketplace demands that companies provide the best products at the lowest possible price.

For many companies, including Pizza Hut, labor expense represents the single largest component of their cost structure.

TJTC allows companies to offset the added cost of training individuals who have little or no work experience. TJTC gives restaurant managers the extra ability to hire and train individuals who need additional support, while still allowing the managers to control their labor costs.

The absence of TJTC will force companies to find new ways by which to reduce their labor expense, such as automation, thereby reducing the number of these "first job" opportunities.

Our strong endorsement of TJTC is evident throughout the Pizza Hut organization. In addition to our outreach programs, Pizza Hut has a full-time staff dedicated to providing assistance and training to our restaurant managers on how to better focus recruitment efforts on those groups that typically are more difficult to access, such as general assistance and AFDC recipients.

By promoting these types of corporate efforts, TJTC helps reduce the dependence on governmental support programs, a certain type of welfare reform, if you will.

Each year, Pizza Hut invests a significant amount of capital to promote program usage where it must occur, in our restaurants. To this end, we have developed an incentive program to reward our restaurant managers for successfully hiring and retaining TJTC employees.

Through the use of this bonus incentive, we have been able to achieve the tremendous growth mentioned earlier in my testimony.

These three ingredients—outreach, support staff, and incentive, have been the winning combination which allows Pizza Hut to be a leader in the hiring and retention of TJTC employees.

There is, however, a cost in real dollars, associated with each of these three elements. The presumption that TJTC is a windfall for business is without merit.

Much like any tax incentive, or economic stimulus, TJTC is a partial offset to the investment of real and incremental dollars.

In closing, I would like to leave you with these thoughts. I respectfully submit that this new TJTC is a good and sound program. It helps create that ever-important "first job" for thousands of our citizens each year.

TJTC's tax benefits support employers' most innovative outreach programs for the previously unemployed and for the profoundly disabled.

To promote employer commitment to the program, first, the new TJTC should be made a permanent part of the Tax Code. Second, the certification process should be uniform in all 50 States.

If Congress can do this, employers will be able to continue creating "first-job" opportunities for thousands of economically disadvantaged, or physically disabled citizens each year.

Thank you very much.

[The prepared statement follows:]

STATEMENT BY H. SHEPARD BAILEY
DIRECTOR - TAXES, PIZZA HUT, INC.
HOUSE COMMITTEE ON WAYS AND MEANS
OVERSIGHT SUBCOMMITTEE
MAY 9, 1995

Good morning. My name is Shep Bailey. I am the director of tax at Pizza Hut, Inc., based in Wichita, Kansas. I am appearing on behalf of the National Council of Chain Restaurants, in support of the enactment of a permanent Targeted Jobs Tax Credit (TJTC).

Before I begin my explanation of Pizza Hut's past experiences with TJTC, I would like to emphasize that Pizza Hut is one of the largest employers of individuals from the groups targeted by the former TJTC program. As such, we are naturally aware of the concerns that some have raised regarding certain aspects of that program, as well as the manner in which it was used by some employers. Pizza Hut, as well as PepsiCo, Inc. through its other restaurant divisions, has been involved with other employers to provide recommendations to Congressmen Houghton and Rangel of ways to develop a new employer tax credit which addresses those concerns. Pizza Hut commends Congressmen Houghton and Rangel for developing the draft legislation you have before you today. We look forward to working with Congressmen Houghton and Rangel, and you, the members of the Committee to enact this important legislation.

TJTC is an effective and efficient hiring incentive. Since 1990, Pizza Hut has provided job opportunities to over 30,000 TJTC eligible applicants. These job opportunities represent the all-important first steps for inexperienced workers to acquire the skills necessary to advance in today's competitive job market. For the 5-year period ended 12/31/94, Pizza Hut has experienced a compounded growth rate in TJTC hires of over 20%. This is in spite of the most recent 14-month hiatus in the program.

Pizza Hut is committed to finding new and innovative ways to reach out to individuals who might not otherwise have job opportunities available to them. One program, Jobs Plus, originally designed to designate one position in every Pizza Hut unit for persons with disabilities, is a clear example of how TJTC is used to achieve its intended result. This initiative has allowed over 13,000 persons with severe disabilities to become productive members of our workforce. Today, due in large part to Jobs Plus, Pizza Hut is heralded as the nation's leading employer of persons with severe disabilities. As for many employers presently using TJTC, the tax credit provided by the program was an important factor in Pizza Hut starting the Jobs Plus program.

Pizza Hut recently conducted a survey of our restaurant managers to determine overall satisfaction with the performance of employees with disabilities hired through Jobs Plus. The results were great. Ninety-seven percent of the managers reported that there were no performance problems with Jobs Plus employees. Additionally, 71% of the managers reported that their Jobs Plus employees had been sourced through a collaborative effort with an outside rehabilitation agency.

Two significant points are clearly based on the results of our Jobs Plus survey, 1) TJTC, through Jobs Plus, helped to dispel the myth that performance of employees with disabilities is unfavorable as compared to other employees, and 2) that TJTC is a vehicle by which the time gap between public employment training programs for those with disabilities, and their hiring by the private sector can be shortened.

Today's marketplace demands that companies provide the best products at the lowest possible price. For many companies, including Pizza Hut, labor expense represents the single largest component of their cost structure. TJTC allows companies to offset the added cost of training and turnover of individuals that have little or no work experience. The absence of TJTC will force companies to find new ways in which to reduce their labor expense, such as automation thereby reducing the need for people.

Unfortunately, the "on-again, off-again" approach to TJTC has been a barrier to Pizza Hut's effort to grow our program much beyond the 10% mark as a mix of our total employee base. Our restaurant managers are constantly on the lookout for ways in which to manage their costs. TJTC gives managers the extra ability to hire and train individuals who need additional support while still allowing the managers to control their labor costs.

Our strong endorsement of TJTC is evident throughout the Pizza Hut organization. In addition to our outreach programs, Pizza Hut has a full-time staff dedicated to providing assistance and training to our restaurant managers on how to better focus recruitment efforts on those groups that typically are more difficult to access, such as General Assistance and AFDC recipients. By promoting these types of corporate efforts, TJTC helps reduce the dependency on governmental support programs.

Our TJTC staff also works closely with the various state employment security agencies to reduce the often burdensome documentation required of employers to obtain certification. Our ability to streamline this part of the TJTC process has resulted in a material improvement in program usage at the restaurant level. Several states have sought out our assistance in developing a better mousetrap, thus encouraging more employers to embrace the program. This type of working relationship between the private sector and the states is critical due to the complexity caused by 50 states administering a single federal program in 50 individual ways.

Each year, Pizza Hut invests a significant amount of capital to promote program usage where it must occur, in our restaurants. To this end, we have an incentive program designed to reward our restaurant managers for successful hiring and retention of TJTC employees. Through the use of this bonus incentive, we have been able to achieve the tremendous growth mentioned earlier in my testimony.

These three ingredients, outreach, support staff, and incentive have been the winning combination which allows Pizza Hut to be a leader in the

hiring and retention of TJTC employees. There is, however a cost, in real dollars, associated with each of these three elements. The perception that TJTC is a "windfall" for business is invalid. Much like any tax incentive or economic stimulus, TJTC is an off-set to the investment of real dollars.

On eight occasions prior to today, Congress has improved upon the program to ensure the original legislative intent. To further promote utilization and long-range commitment, Congress could improve once again by taking the following actions. First, make the TJTC a permanent part of the tax code. Next, provide private sector employers relief from the fear of litigation through the development of an EEOC-approved, pre-job offer TJTC questionnaire. Both of these actions would then allow employers to make long range plans, as well as dedicate the resources, to support much needed outreach programs necessary for program success. And finally, develop a standardized certification process. This would eliminate the burden on employers caused by varying administrative procedures at the state level.

Thank you.

Chairman JOHNSON. Thank you, Mr. Bailey.
Mr. Wright.

STATEMENT OF JOHN WRIGHT, PRESIDENT, WRIGHT III FOODS, INC., MCALLEN, TEXAS; ON BEHALF OF NATIONAL RESTAURANT ASSOCIATION

Mr. WRIGHT. Thank you. My name is John Wright, and my wife, Melinda, and I, own Burger King franchises on the Mexican border in South Texas. We started our business with 1 restaurant in 1976 and have grown to 9 restaurants with 336 employees today. We have survived despite citrus freezes, hurricanes, oil spills, and peso devaluations in 1976 and 1982, and we are now enduring the effects of the devaluation of December 1994.

Our SMSA, standard metropolitan statistical area, has the highest unemployment rate in America, and the lowest per capita income. The population of Hidalgo, in Cameron County, Texas, is approximately 800,000, and is 85-percent Hispanic. The Rio Grande Valley is home to well over 100,000 U.S. citizens who are migrant workers.

Their seasonal employment too often locks them into a cycle of low education and poverty. One of the few ways to break this cycle is to provide incentives to private sector employers who hire these and other disadvantaged individuals, and provide them on-the-job training and work experience. Each year, in March and April, huge numbers of families leave their homes in South Texas to follow the agricultural crops in the north. As students leave with their families in April, their spring semester is ruined, and because they do not return until October, their fall semester is disrupted also. Too often, these families are forced onto public assistance between October and May, if not year around. These are the young people we were able to employ through the Targeted Job Tax Credit Program.

From 1986 through 1993, we used the TJTC Program, and our experience was gratifying. Through the offices of the Texas Employment Commission, we placed job orders, prescreened, interviewed, and hired numerous young people in this targeted group. With the TJTC Program, they got job experience that provided them a way to break out of the migrant population. Our organization is now filled with such employees, including production leaders, assistant managers, even restaurant managers, who came to us through this TJTC Program. They have learned the skills of teamwork, communication, coordination, and personal responsibility that are required in the workplace.

The restaurant business is unique in its requirement that employees master both the disciplines of production management and of retailing. In addition, every employee, regardless of their previous experience or lack thereof, learns to deal with our customers in ways that will bring them back to Burger King.

The 104th Congress should enact TJTC reform legislation which would create opportunities in the private sector for these and other high-risk young people. Those others in the restaurant business offer many disadvantaged individuals their first stable job, and their first stable social environment, so they can learn and grow.

TJTC is an excellent incentive to hire, train, and retain these youngsters. As an employer who stopped participating in the pro-

gram because of its complexity, I encourage you to establish a simplified process that would minimize the bureaucratic hurdles that now confront small business owners who want to participate. It should be administered through State employment commissions, thereby helping large and small employers, and expanding the number of disadvantaged individuals who benefit. The program should target, among others, less educated and less skilled workers.

This is a valuable program that should be revised, simplified, and retained.

Thank you.

Chairman JOHNSON. Thank you, Mr. Wright.

Mr. Edwards.

STATEMENT OF DAVID EDWARDS, VICE PRESIDENT, ASSOCIATE RELATIONS, GREAT ATLANTIC AND PACIFIC TEA CO. (A&P), MONTVALE, NEW JERSEY

Mr. EDWARDS. My name is Dave Edwards and I am vice president of Associate Relations for the Great Atlantic and Pacific Tea Co., headquartered in Montvale, New Jersey.

I appreciate this opportunity to testify on behalf of my company and the Food Marketing Institute.

A&P operates over 1,100 supermarkets in the United States. In addition to operating as A&P, we operate as Waldbaum's Food Mart in Connecticut and Massachusetts, Waldbaum's on Long Island, Food Emporium in Manhattan, Super Fresh in the Mid-Atlantic States, Kohl's in Milwaukee, and Farmer Jack in Michigan.

A&P's total employment in the United States exceeds 67,000. A&P has participated in the TJTC Program for many years, and I have managed the program at A&P since 1992.

The Food Marketing Institute, FMI's membership, is composed of large multistore chains, small regional firms, and independent supermarkets.

We recognize that there have been criticisms of the old TJTC Program, and would like to pledge our support for a new improved TJTC Program as outlined in the discussion draft offered by Congressmen Houghton and Rangel, and the work done by the Committee for employment opportunities.

Their changes offer improvements which will allow our industry to continue utilizing this effective program.

Strong local economies begin with strong neighborhoods. Supermarkets play an important role in creating and maintaining strong neighborhoods. They also provide many young people with their first work experience.

These characteristics provide supermarkets with the unique opportunity to play a leadership role in developing programs to address the social and economic challenges of the neighborhoods and communities they serve.

Many companies, including A&P, have found that a good way to increase store manager awareness and program support is to credit the store earning the tax credit with their TJTC dollars on the individual store profit and loss statement.

There is no doubt that this practice has contributed to the fact that TJTC new hires have longer retention rates than non-TJTC new hires.

This practice has the additional advantage of increasing the operating profits in locations that serve the TJTC-eligible community.

At times, these tax credits have made the difference in a decision to close a store or consider opening a new store in a specific location.

TJTC has encouraged retailers to operate stores in areas where many TJTC-eligible employees reside.

Many of these people are unable to travel in their neighborhoods. By our being there, we often provide the first job, and first formal training that many of these people ever receive.

TJTC has been the vehicle for many to take the first step from dependency to becoming a taxpayer.

The TJTC Program is one reason why more supermarkets operate today in depressed areas compared to two decades ago.

Supermarkets offer a wide variety of products at competitive prices. The reopening of inner city stores has made food and other staple items more affordable in areas where the need to stretch the purchasing power of dollars and food stamps is paramount.

The TJTC Program has served to make these stores more viable, and failure to continue the TJTC Program could result, over time, in more than a loss of jobs.

The issue is do you believe people in these categories should be helped? If so, who is better prepared to do it? Business or the government?

I think the answer is business, because we provide real jobs. TJTC has been one of the most cost efficient and effective programs for encouraging private sector employers to hire people who are not currently in the work force.

Over the years, many employers have come to realize that TJTC provides the incentives needed to cover the added costs of training and supervising disadvantaged workers, and that TJTC workers can do a good job.

The TJTC Program is an effective program that provides employment, especially in the inner cities, and it should be continued.

We support the changes proposed by the Committee for Employment Opportunities and the Houghton-Rangel discussion draft.

Once adopted, these changes will allow the program to continue to be viable for our industry, as well as potential future TJTC applicants.

Thank you very much for this opportunity, and I would be pleased to answer questions at this time.

Chairman JOHNSON. I hear that you are all in support of the reform program.

Do you support the radically simple approach, where only those who qualified for means-tested programs or Pell grants would be eligible?

You can get back to me on this. I mean, the reason for looking at this, if we are going to do anything in this area, is that it is very hard for small businesses to participate in a program that requires precertification, preidentification, or making sure somebody qualifies.

Since we want to simplify this, you need to think about what would be the impact on your programs if you were only allowed to accept people for this program who were either eligible for a means-tested program or for Pell grants.

There may be some other examples. Certainly disability programs, voc-rehab programs, and things like that, would qualify. You need to think about that.

Then what would be the impact of, with a backloaded requirement, particularly on small business, and particularly on neighborhood businesses, that don't have a backup of an A&P behind them. I mean, what are the accounting problems here. All of you, except for you, Mr. Wright—I am not sure—are part of bigger chains that have the sophistication to just give you the information.

What does backloading do to the participation of small businesses in this program?

Ms. TULLY. I think that the basic, the 35 percent, up front, will help offset the training programs on that, and the backloading will cover that. Mostly, their tax people will take care of it later on, but they know at least that they are paying them reduced wages in the beginning, when they are expending that extra effort.

Chairman JOHNSON. In other words, it is a problem for small businesses because they do not have a tax person.

Ms. TULLY. They do not have a human resource office. Yes. There is no question about that.

Chairman JOHNSON. Yes. That is right. Backloading does make it more complicated. While it could be an incentive to retaining the employee, maybe there are other ways of retaining an employee without getting into a level of complexity that would make it hard for small businesses to participate.

One of the things that has been significant about this program, and just from the information that I—and I am not an expert—but it has been over the time, clearer and clearer to me, and a greater concern, it is the big corporations that are able to do this.

If it is going to be primarily a big corporation program, which it might well be—and it does not mean that it would not be useful—should we require, to qualify for these benefits, that a company should actively recruit? They should actively recruit, actually go into the neighborhoods where there are the majority of people who need this kind of support.

Should we make that a qualification for participating in the program, for a company to demonstrate that they have an affirmative recruitment program?

Mr. EDWARDS. We do not think you should. Many of the people that are in these categories are very reluctant to go to places where we would recruit.

They are uncomfortable with the process. They know where the local store, or the local business facility is in their community, and they may know somebody who works there.

They are more comfortable, in many cases, going right to the location to apply for the job, and I think if you specifically eliminated those that came directly to the store location, you would effectively eliminate many of the people that the program tries to get at.

Chairman JOHNSON. Other comments?

I was not suggesting that you would not also be able to hire off the street.

One of the things that has been remarkable about affirmative action, the whole affirmative action approach, is not so much the quota system, but the requirement on employers to affirmatively recruit, and that has meant that jobs are advertised in areas where they have not been advertised, and has provided really much greater access.

It is really that kind of recruitment effort that Pizza Hut has made toward the disabled, but it could easily be made in neighborhoods of certain cities.

Beyond the walk-in eligibility, and certainly the neighborhood service, that employers using this credit could provide, the issue of recruitment does interest me.

I am going to yield to my colleague, Mr. Portman.

Mr. PORTMAN. I thank the Chairwoman and thank you all for being here today.

It was very interesting for me to hear your statements, from personal experience.

There are a number of studies, of course, that are very troubling to me and to others who are fiscal conservatives, trying to figure out ways to decrease our budget deficits. This program, net, maybe $250 million a year. Perhaps you can correct me.

It is a revenue hit to the government as are all of our tax credits. We want to make sure it works and works properly. If you look at the GAO, General Accounting Office, study, look at the Department of Labor studies, they would indicate that many of these people would be hired anyway.

That conclusion is only affirmed in my district among the employers with whom I have spoken. They have come forward, these employers, and said we get the tax credit, we are happy to receive that from the Federal Government, but, frankly, we would hire these people anyway.

This is a program that I am very skeptical about. I was very pleased to learn, a couple of days ago, about the reforms, and I have now had a chance to look at them, and then to hear your comments, all four of you supporting the reforms being promoted by Mr. Houghton and Mr. Rangel, and I am very pleased to see that.

I guess if I could ask a couple questions about the reforms and see whether they get at the kinds of problems that I perceive that are in the program currently.

Ms. Tully, you talked about the importance of the screening, and I guess you are indicating that the so-called windfall in the program now, which again I think has been evidenced by some of the studies, and again, some anecdotal evidence, would not occur with screening because people would not be hiring folks, they would otherwise hire, that in fact they would only be hiring people eligible for the credit because they would have to go through a certification process in advance.

Why do you think that the windfall would not continue to be there?

Ms. TULLY. You know, right now, one big problem that we have is the job market is becoming very small. We have now, at Marriott, people who are with college degrees, applying for secretarial

positions, for entry-level positions as bellmen, front-desk clerks. It is a very competitive job market out there.

These folks are competing with college graduates for entry-level positions. When you are saying we would hire these people anyway, I cannot totally agree with that. I do not think we would be hiring these people anyway.

I just want to say, we really do not totally agree with the OIG, Office of Inspector General, study. I frankly believe in some cases, when you know what your outcome is going to be, and you ask questions that will give you the kind of outcome you want, then you have the kind of report you want.

That is how I feel about the way the particular survey was conducted.

I do not feel now, and it is only now with welfare reform, we are saying that people are going to be 2 years on and out—where are these people going to go?

They are going to have to find jobs. And where are the people with the jobs trying to—

Mr. PORTMAN. Let's back up a moment. You would dispute the findings—

Ms. TULLY. I would dispute those findings; yes, sir.

Mr. PORTMAN [continuing]. The 1994 audit findings of the 92 percent. You would dispute the premise of my question, which was assuming the current program leads to people receiving a credit who would hire these same employees anyway, why are we giving the credit and how can we improve the program.

Your answer to that is that you do not agree with my premise. You think that in fact there is not a problem in the current system with regards to folks being hired anyway?

Ms. TULLY. No. I agree that there is some problem in the current system. I agree with that. I do not feel that all the people hired under TJTC in the past would have been hired anyway. I do feel now that—

Mr. PORTMAN. Instead of 92 percent, you think it is closer to 50 percent? What would your gut tell you?

Ms. TULLY. I can only speak for Marriott, and I know that we have a lot of outreach programs for people we have hired, who probably would not have had the opportunity, had we not been involved in these outreach programs because of the targeted job tax credit. Definitely with that. I feel very strongly that prescreening will make sure that employers give preferential treatment up front.

Something we would have liked to have done in the past is to make sure that all the people that we are hiring, that are TJTC-eligible, to give them an extra chance, knowing, of course, that when you are hiring a TJTC person, you are going to spend a lot of time and effort, up front, coaching and counseling, and working for these people.

Some of these people are going to be well worth it, given the opportunity, and that is really what TJTC is about, is actually giving these people the opportunity, making us spend a little bit of extra time, and not just saying, "Hey, you just did not make it, goodbye, you are out of here."

The manager is going to spend some extra time working with these folks to get them over that first hurdle.

Mr. PORTMAN. Mr. Bailey is physically moving back and forth in his chair as if he might want to say something. I think you understand my question and my concern.

Do you have a response to it?

Mr. BAILEY. Yes. Aside from what some have called abuses, whereby wholesale attempts are made by some users to certify within certain categories—I have a fundamental problem with this being characterized as corporate windfall, or corporate welfare.

I think that in fact, as the law is intended, TJTC is designed to provide a level footing, a level playingfield for individuals that otherwise might not have it, and at the same time protect or compensate the employer for taking that additional measure of risk.

If the program is administered, whether we are talking the old program or the new program, in the way in which it was intended, absolutely, I have a fundamental problem with regarding it as corporate welfare, or a corporate windfall.

Mr. PORTMAN. Again, just very briefly—I do not know how much time I have, Madam Chairwoman—but I will just restate the fundamental concern, and that is that many of these people would have been hired anyway, whether you believe it is 92 percent or 50 percent.

Why should you get a tax credit when your competitor, or another business, is not in your line of work, does not get a tax credit for hiring these same people? That many of these entry level jobs go begging now. In my area, we have about 3.3-percent unemployment.

Our white-collar problem, incidentally, Ms. Tully, is probably more dramatic in my area right now because of the changes at the middle management level out weighing the entry level. That is our problem.

Those people get no support from the Federal Government. In fact they go to the employment services, which is geared toward blue collar and toward entry level, and they are not getting any help.

With the scarce Federal dollar, in fact we are in a situation where we have no dollars, so everything we are giving, we are borrowing to give to corporations.

The question is, how can the program be streamlined to make it work better to handle that concern?

That is my question. I am not calling it corporate welfare. I did not use the word windfall. That was a term used in the study, and the administration has used it.

The fundamental premise I think continues to be true, that at least some of these people, maybe it is not 92 percent, maybe it is 50 percent, would have been hired anyway in the course of ordinary business.

Why should you be receiving a tax credit to do that? I think what Pizza Hut has done with the disabled community is exceptional; that sort of outreach. Maybe, that is required, as the Chairwoman indicates.

Maybe, that should be part of the Federal requirement, should the tax credit be available. Those are the kinds of questions that I am going to have over the next several weeks as we look at the program.

Do you have any comments?

Mr. EDWARDS. Yes. Certainly, in any case, some of the people, no matter what you do, the TJTC-eligible person, at times, is going to be your best candidate.

There is never going to be a program where you would bring in 100 people, and say that there might not be somebody that was TJTC-eligible, that would not have been hired anyway.

The program is never going to be 100 percent perfect. But the prescreening is certainly going to level the playingfield more toward the TJTC-eligible person.

While you could say that some might be hired anyway, the new program will insure many more targeted individuals will be hired. We think that makes a pretty good return on investment for a fiscal conservative like yourself.

Mr. PORTMAN. A good answer.

Chairman JOHNSON. Mr. Ramstad.

Mr. RAMSTAD. Thank you, Madam Chair, I want to applaud your leadership in calling this hearing today on the expiring tax provisions under consideration.

I certainly agree with much of what has been said, that the process under which these items are extended every few months, to put it very mildly, makes business planning extremely difficult. I mean, it is absurd, in terms of any long-range planning for business, not to know the rules of the game, so to speak.

I am hopeful we can deal with each of these provisions this year on a permanent basis.

I would like to ask any of the Members of this panel a couple of questions.

First of all, I am curious as to your reaction to Doug Ross' testimony this morning from the Labor Department, which I assume is the administration's position.

Ms. Tully, or Mr. Bailey, Mr. Wright, Mr. Edwards, would you care to comment?

Mr. BAILEY. I would be glad to.

I think that Mr. Ross' testimony seems to call for the solutions which in fact have been incorporated in Congressmen Houghton and Rangel's draft legislation, and in fact seemed to be a relatively strong endorsement of the very elements in this new draft legislation, not getting into whether I necessarily agree with Mr. Ross' criticisms of the old program.

The things that Mr. Ross is recommending as improvements, as ways to craft this legislation in such a fashion that he would feel comfortable, and the administration would feel comfortable in supporting, are in fact elements of the new draft legislation. I am quite comfortable with his recommendations.

Mr. RAMSTAD. That was precisely my question, whether the critique that he leveled is addressed by the elements of the legislation before us, Mr. Houghton's bill.

Do you agree with that, Ms. Tully?

Ms. TULLY. Very much so. I believe they are.

Mr. RAMSTAD. I see the other two witnesses nodding affirmatively.

Let me ask you a question Mr. Wright. I am just curious. Even though you no longer participate in the program, have you continued hiring individuals from the targeted group?

Mr. WRIGHT. We got out of the program due to the complexity of it.

To respond to Congressman Portman's question a minute ago, we are in an area where given the language and life skills of the TJTC population, we would not ordinarily hire from this group.

These are young people who go to both of your States in the spring of the year and return to the Rio Grande Valley in the fall of the year.

They do not have the life skills that we talked about. No one in their family has ever had a checking account. English is their second language. These are clearly people who ought to be targeted by a Federal program. They would not ordinarily comply with those requirements that Burger King or my company would have.

Mr. RAMSTAD. Well, I thank you, Mr. Wright, for that response.

I just want to conclude, Madam Chair, by saying that I, too, classify myself, or characterize myself as a fiscal conservative. I think my record supports that characterization.

My bias is in favor of revamping this, along the lines of the Houghton bill. I think you put it best, Mr. Edwards, you said that business can do it a lot better than government. I think that, succinctly, is the reason why we should give this legislation every serious consideration.

I want to thank the witnesses for being here today.

Chairman JOHNSON. I would like to thank the witnesses also. Your experience is very helpful to us.

The next panel will be Susan Oven, manager of the targeted jobs tax credit services for Dayton Hudson Corp. in Minneapolis; James Hubbard, the director of the National Economic Commission of the American Legion; and Scott Shipman, senior manager, government affairs, Shipman, Maison and Associations of Chicago.

While the panel is assembling, I would like to yield to my colleague from Minnesota.

Mr. RAMSTAD. Thank you again, Madam Chair.

I want to welcome this next panel, particularly Ms. Oven, Susan Oven, who represents the International Mass Retail Association. As you said, Ms. Oven is a manager of TJTC services at Dayton Hudson in Minneapolis and has provided me with important input on this program.

I know that Dayton Hudson is a very active participant in this program, having hired, Madam Chair, over 138,000 TJTC-eligible individuals over the last 10 years.

So given this experience and this tremendous buildup, Ms. Oven is in an excellent position to give our Committee insight today, and I really appreciate your coming here today, Susan. It's good to see you again. And welcome to all the witnesses.

Chairman JOHNSON. Thank you. Welcome, Ms. Oven, you may proceed.

STATEMENT OF SUSAN OVEN, MANAGER, TARGETED JOBS TAX CREDIT SERVICES, DAYTON HUDSON CORP., MINNEAPOLIS, MINNESOTA; ON BEHALF OF INTERNATIONAL MASS RETAIL ASSOCIATION AND NATIONAL RETAIL FEDERATION

Ms. HUDSON. Thank you.

It is my pleasure to speak to the Committee today in support of the revised TJTC Program. As Congressman Ramstad indicated, I have been involved with the TJTC Program at Dayton Hudson since 1988.

It is my job to help our stores with all aspects of managing this program. Basically, I am where the rubber meets the road. When the law is passed, it is my job to see that it is implemented, correctly and accurately, at all our stores.

I have submitted written testimony, and what I would like to talk to you about today is some of my experiences that I think illustrate the benefits of this program.

I am here today not only on behalf of my employer, but I speak also for the National Retail Federation, and the International Mass Retail Association.

As retailers, I think that we all are extremely mindful of the need to maintain the health of our economy.

If consumers in our economy are not willing to spend, we are out of business. When I speak in support of the targeted jobs tax credit, I am mindful that we want a program that works in the overall economy. We do feel that this is such a program, and has been for us.

Let me tell you a little bit about my experiences with TJTC as an employer. My job is to help our stores find and recruit TJTC-eligibles, and my written testimony speaks to that overall goal. I want to tell you what it is like to be an employer and hire a TJTC-eligible person.

I am going to tell you about a couple people that I think will show you what happens at that employer-employee relationship.

The first young woman I want to tell you about came to us from a YWCA Teen Mom Program, a program designed to get young mothers off of welfare. She was a student going to school to study nursing, in a nursing assistant program, and worked for me part-time in a telephone capacity.

From the time that she was hired, she began learning the job functions. It was apparent that she was a bright young woman.

A training program was not an issue for her. Listen to some of the things that she did not know. She did not know that you needed to come to work every day that you were scheduled.

She did not know that you needed to come to work on time. She did not know that if you were going to be late, or needed to call in sick, you needed to do that before your shift started.

Those sound like very elementary things for an employee, or a potential employee to know. This young woman had no role models. There was no one in her family that had a job. This was her first job.

There was no way that she was going to know those things before she came to work for us.

Janet Tully referred to the coaching and counseling that you go through with a new employee. Normally, most companies have a probationary period. In our case, an employee is expected to be up to speed in the first month.

I would say it was easily the first 3 months. This young woman got to the point where she was all of the expectations that we had for our employees, things that were a mystery to her when she first came, no longer were.

I think that the time that we spent with her is fairly typical of what an employer goes through with a TJTC-eligible person, and time is money.

No employer is going to choose an expensive hire without an incentive. They are going to look for the best employee at the lowest cost to them.

I will tell you about another young woman that still works for me. The first young woman did graduate from school and went on to a job in her field.

By the time she left, she was a wonderful employee, and we hated to lose her. I will tell you about someone that still works for me.

She came to us from State Services for the Blind. She is vision-impaired because of a sight loss from Lupus. She uses a special computer screen that enlarges text, so she can see printed words on her computer screen and do her job in that fashion.

Her biggest obstacle was not her vision, or lack of vision. Her biggest obstacle was really lack of confidence. This was her first job also, and she had lost her vision at a fairly young age. She was very frightened to come to work for us.

Despite the fact that she had support from State Services for the Blind, and we had recruited her—so she should have known that we wanted her as an employee, and were willing to go the extra mile to assimilate her into the work force—it was still a tough learning period for her.

Ultimately, we placed her in charge of all of our training, and actually, for the last few years, she has either done all of the training, or trained the trainer in our department.

Her abilities eventually outstripped her disabilities. I just want to summarize and say that I think the investment that this tax credit encourages employers to make for the truly disadvantaged in our society is a perfect fit with what the Congress is looking to do in terms of welfare to work progression.

I urge your support of the program, because I think it will make a valuable contribution toward that goal.

Thank you.

[The prepared statement follows:]

STATEMENT OF SUSAN OVEN
MANAGER, TJTC SERVICES DAYTON HUDSON CORPORATION
ON BEHALF OF INTERNATIONAL MASS RETAIL ASSOCIATION AND
NATIONAL RETAIL FEDERATION

Madam Chairman, Committee Members,

My name is Susan Oven. I am the Manager of TJTC Services for the Dayton Hudson Corporation, headquartered in Minneapolis, Minnesota.

I am testifying on behalf of the International Mass Retail Association (IMRA). IMRA represents more than 170 mass retailers, including discount department stores, warehouse clubs, and off-price stores, as well as 570 major suppliers. IMRA's retail members operate more than 54,000 retail stores and employ over a million individuals. In terms of sales volume, IMRA's members represent the vast majority of the $245 billion mass retail industry in the United States.

The discount retail sector is often referred to as the "new engine" for job creation. Since 1991, the number of jobs in the discount retail industry alone increased over 48% and has represented over 20% of job growth in the U.S. since the economic recovery which began in 1991. The number and nature of retail jobs has caused the Targeted Jobs Tax Credit offering to be a real factor in retailers' willingness and ability to employ TJTC eligible individuals.

Dayton Hudson Corporation, my employer and a member of IMRA, is the nation's 15th largest employer, with about 175,000 employees. Our operating companies include Target stores (an upscale discount retailer), and several department store companies, including Mervyn's, Marshall Field's, Hudson's and Dayton's. We operate over 930 retail stores in 33 states.

In Dayton Hudson alone, since 1984, we have utilized the Targeted Jobs Tax Credit program as an incentive to seek out, hire, train and retain over 120,000 TJTC-eligible individuals.

We rely on TJTC to help offset the incremental costs of hiring and training individuals who do not come "work ready." Without TJTC, we would be far less likely to hire, train and retain most of those who are participants in the program. (When we refer to individuals as not "work ready," we mean those who do not have experience, training, or a track record of being at work at scheduled times, who do not have basic customer service skills, or who cannot perform entry-level job requirements without extra training and investment on our part.) TJTC has motivated our hiring, training, and retention of such individuals.

In our efforts to utilize the TJTC offering, we have, for 10 years, maintained an internal staff to work with all of our stores on TJTC, to develop relations with state employment agencies, to educate our hiring managers and to give evidence to our entire company of the value of our being active participants in TJTC.

This committee and other members of Congress are now deliberating on the alternatives of continuing or ending this program.

There are several reasons we find TJTC to be effective in its purposes:
First, TJTC places the incentive to hire with the employer. While the hiring manager does not know for a fact that a given applicant is TJTC qualified, that manager looking at a given application form has a very clear indication of that qualification (e.g. periods of unemployment, lack of work experience, spotty employment history, etc.).

Second, once an individual is hired and working, the employee's TJTC qualification is known, and the TJTC credit has a significant influence on our willingness to retain eligible employees.

Third, because of the TJTC credit, every district of our various businesses has direct contact with numerous local agencies which help place disabled workers, AFDC recipients, and members of other under-employed groups. We also have a national agreement with GoodWill Industries to place their candidates, many or most of whom are TJTC eligible.

In short, TJTC is an important factor in our efforts to hire, train, and retain those eligible under TJTC regulations.

What we hear you asking is, "Does TJTC truly result in the hiring, training, and retention of individuals whom you otherwise would not hire, train and retain?"

Our answer is: yes. I will briefly address each of these phases of employment.

1. Hiring

   It would be helpful if we were allowed to determine eligibility prior to employment offer. But as stated earlier, we have become skilled at "guessing" and, in fact, have a clear record of employing TJTC eligibles.

2. Training

   We are more patient and give added effort to the development of job skills in TJTC eligibles because of financial incentives offered through TJTC.

3. Retention

   Our willingness to continue employment of TJTC eligibles is greatly increased, in spite of skills deficiencies, as a direct result of the TJTC program.

The off-again/on-again history of the program has been disruptive to the optimal fulfillment of the objectives of TJTC. If such intermittence continues, it will erode further the willingness of businesses and involved government agencies to give it appropriate support.

Therefore, we argue not only that TJTC is effective and should be renewed prior to the December 31, 1994 expiration date, but also that you give TJTC either permanent status or a long-term life of five to ten years.

If Congress contemplates substantive changes in a renewed TJTC program, representatives of our company would be eager to be of counsel to you and your staff organizations on issues of concern.

Thank you, Mr. Chairman, for this opportunity to testify in favor of TJTC being renewed on a permanent or long-term basis.

Chairman JOHNSON. Thank you very much for your excellent comments.

Mr. Hubbard.

STATEMENT OF JAMES B. HUBBARD, DIRECTOR, NATIONAL ECONOMIC COMMISSION, AMERICAN LEGION, WASHINGTON, DC

Mr. HUBBARD. Thank you, Madam Chair, for this opportunity to testify on behalf of our 3.1 million members.

I am here not as an employer representative, but as the representative of a constituency that exists out there, a lot of whom need help.

Let me summarize, briefly. We know that black and Hispanic veterans experience higher rates of unemployment than their white counterparts.

We know that a black male veteran is twice as likely to suffer the rigors of unemployment than a white male veteran.

Of all the veterans with a disability rating of 60 percent or more, over two-thirds are out of the work force. The unemployment rate for veterans, as a group, is below that for the population in general; but the unemployment rate for male veterans between 20 and 35 years old is up to 11.8 percent.

There is strong evidence that the subsidy involved in the operation of TJTC is seriously overstated. If you put a veteran to work, or anybody on TJTC, to work earlier, or at all, than they otherwise would have gone to work—welfare payments, unemployment compensation, other general assistance payments are significantly reduced. That is a cost savings.

We believe that there needs to be a study done on this, to get away from this static analysis that we do when we examine the cost of these things.

Let me put something else in perspective. The airline folks were saying that a 4.2 cent additional tax on airline fuel is going to cost jobs in the industry. In fact somebody mentioned Boeing losing 50,000 people.

That makes headlines. The Armed Forces lay off 250,000 on an annual basis, and nobody knows it, and nobody seems to care.

Half of these people released are married. They will need immediate assistance in order to provide for their families. More than 30 percent of them are minorities. Some of them will return to the inner cities where unemployment is endemic.

Eleven percent of those people released from the armed forces are women. In some cases, the spouses of former service people will need assistance in finding meaningful employment.

With the exception of the very limited funds available under the Job Training Partnership Act, title IV(c), TJTC is one of the few tools available to employers across the nation to help these people coming out of the armed forces.

In conclusion, Madam Chair, we believe that TJTC is one of the most efficient and cost-effective of Federal programs.

With TJTC nobody loses. Economically disadvantaged workers gain an opportunity to demonstrate their ability to become productive members of society. They move toward financial independence.

Employers are able to hire a capable work force and receive a tax credit. The public assistance rolls are reduced as workers move from welfare and unemployment roles to the tax roles.

We would like to see an extension of TJTC, with the particular model being the reforms introduced by Mr. Houghton and Mr. Rangel.

Thank you, Madam Chair.

[The prepared statement follows:]

STATEMENT OF JAMES B. HUBBARD
DIRECTOR, NATIONAL ECONOMIC COMMISSION
THE AMERICAN LEGION
TO
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

May 9, 1995

The American Legion is pleased to present to this committee the views of our 3.1 million members on the Targeted Jobs Tax Credit proposal before the Congress. In the best of all possible worlds, we would like to see this program made permanent. As this committee is aware, the checkered history of TJTC over the past several years has caused the program to be much less effective than would be the case if it were permanent. Each hiatus between extensions causes more confusion and more employers drop out causing fewer veterans to be hired.

We are extremely pleased that the proposal expands the eligibility from serving only Vietnam era veterans to veterans who are economically disadvantaged. It is right and proper that this nation should offer an employment subsidy targeted at workers or potential workers who have borne the burden of unemployment at a rate higher than the rest of society. In our view, the historical imbalance seen in the distribution of unemployment can only be remedied by the creation and continuance of incentives for employers to make extra efforts to hire those targeted workers, which include the disabled, minorities, veterans and others. TJTC has served these groups well by creating an "employment advantage" for these groups.

Veterans have been one of the beneficiary groups served by TJTC for some very good reasons. Apart from the fact that these men and women donated a portion of their lives, and in some cases risked their lives for our country, some of them are now chronically unemployed. They need the assistance of this nation and TJTC can help. The data tabulated by the Department of Labor and published as WORKFORCE 2000 AND AMERICA'S VETERANS is still valid. Consider the following from that report:

Black and Hispanic veterans experience higher rates of unemployment than their white counterparts.

A black male veteran is more than twice as likely to suffer the rigors of unemployment than a white male veteran.

Of all the veterans with a disability rating of 60% or higher, more than two-thirds are out of the labor force.

While the unemployment rate for veterans is somewhat below that for the population in general, the unemployment rate for male veterans between 20-35 years is up to 11.8% according to a Department of Labor Survey.

The Targeted Jobs Tax Credit works. The Wharton School of Business at the University of Pennsylvania has concluded that the program has been effective in fulfilling the objectives for which it was intended. TJTC also works for veterans. Between twenty-five and thirty thousand veterans per year have obtained meaningful employment through the TJTC program.

There is also strong evidence that the subsidy involved in the operation of TJTC is seriously overstated. It is very likely that welfare payments, unemployment compensation, and other general assistance payments made to unemployed workers are significantly reduced when TJTC induces employers to recruit and hire eligible people. We believe that the Departments of Labor and Health and Human Services should jointly do a study of the dollar amount of transfer payments saved by those employed through the TJTC program.

This committee should also be aware that as the United States military begins to grow substantially smaller, there will be more veterans on the street seeking work. In the next five years, the size of the armed forces will be reduced by approximately 500,000 people. Over one half of the people released are married, and will need immediate assistance in finding employment in order to meet the responsibilities of caring for a family. More than 30% are minorities, some of whom will return to the inner cities where unemployment is endemic. About 11% of those released will be women. In some cases, spouses of former service men and women will also need assistance in finding meaningful employment. With the exception of the very limited funds available under Title IV-C of the Job Training Partnership Act ($9.0 million), TJTC is one of the only tools available to the employment services across the nation to help these people. Funding for a program under the Service Members Occupational Conversion and Training Act has run out.We are not concerned with those members of the military who have learned a marketable skill while on active duty. We are concerned with those who have served their country in the infantry, armor or artillery branches of the Army or the Marine Corps or in the Air Force, Navy or Coast Guard where the skills learned are not directly transferrable to the civilian workforce. Many of these people are minorities from inner cities who will qualify for TJTC. As I have mentioned before, many of these same people are married with families. TJTC can be an important tool for them.

The American Legion has concluded, Mr. Chairman, that TJTC is one of the most efficient and cost effective of all federal assistance programs. With TJTC nobody loses. Economically disadvantaged workers gain an opportunity to demonstrate their ability to become productive members of society and to move toward financial independence. Employers are able to hire a capable work force and receive a tax credit. The nation's public assistance rolls are reduced as workers move from the welfare and unemployment rolls to the tax rolls. The American Legion respectfully urges a permanent extension of the TJTC program.

Chairman JOHNSON. Thank you very much, Mr. Hubbard.
Mr. Shipman.

STATEMENT OF SCOTT D. SHIPMAN, SENIOR MANAGER, GOVERNMENT AFFAIRS DEPARTMENT, SHIPMAN, MAISON & ASSOCIATES, LTD., CHICAGO, ILLINOIS; ACCOMPANIED BY R. WALTER SHIPMAN, PRESIDENT, SHIPMAN, MAISON & ASSOCIATES, LTD.

Mr. SHIPMAN. Thank you, Chairman Johnson.

Madam Chairman, Members of the Committee, my name is Scott Shipman. I am the government affairs manager with the firm of Shipman, Maison & Associates. We are a tax financial services firm based in Chicago.

Through our CEO, we have been involved with the TJTC Program since 1978, and I think of people providing testimony today, we might bring a little different perspective to this hearing, the idea being we suggest using software systems to help manage the administration of the TJTC Program, such as streamlining of the TJTC process, if you will, could help this program be more beneficial not only to the applicants but to the State governments currently administering TJTC, as well as the employers.

Madam Chairman, through use of software, you can use this software at the local, State, or Federal level, and provide pools to job applicants, if you will, ready to go to refer to job placements, currently, that employers need.

I believe Congressman Houghton himself suggested the process, the mechanics of this system, are what I would call "lurchy." They take a long time. It is very inefficient and it takes taxpayers' money to do such a program.

What we are here to suggest, and inform you of, is that maybe software might be a good way to help this program along through more efficiently and more economically managing TJTC.

Specifically this system can help certify a TJTC applicant in 10 minutes. That is pretty quick. In some States, that takes months, and naturally, the applicant has to fill out lots of paperwork and the employers are forced to bear a burden of waiting, and trying, and coaching to get this paperwork processed.

Also, many of the States are just completely inundated with paper. Some of it is accurate, some of it is not. Some of it is not legible. It is very burdensome to them, seeing how their funding is cut and their staffs are cut every year by the discontinued use of this program.

Through software, and through the use of suggesting applicant pools to the employers, the system would be smoother and more easily managed.

For example, this system would fit in very nicely with the Department of Labor's one-stop shopping concept.

You would have in the corner of a one-stop shopping center a TJTC booth, where an applicant could go, be prescreened, vouchered and certified, again, in less than 10 minutes.

If you will allow this illustration. Software systems could help the administration of this program in much the same way ATMs help banking. That is, provide accurate, faster service at less cost.

Other programs that this system could complement would be the Immigration and Naturalization's I–9 Program. Through the use of Social Security numbers, TJTC screening could help with that program also, as well as the Jobs Training Partnership Act.

In the latter half of 1994, our home state of Illinois tested this system. This isn't some idea that we just kind of dreamed up. It has actually been used and was used very effectively out in the field.

A local employment staff could go to the field, take care of applicants much more quickly on their place or residence, and help the employers receive the tax credit, and provide a much quicker and better service than currently existed before.

We would hope that this program could be expanded to all States who are interested, and if not, the Department of Labor itself.

I thank you for inviting us today. I think it is a great forum to address these issues, and I look forward to your comments.

[The prepared statement follows:]

STATEMENT OF SCOTT D. SHIPMAN
SENIOR MANAGER, GOVERNMENT AFFAIRS DEPARTMENT
SHIPMAN, MAISON & ASSOCIATES, LTD.

Introduction

Thank you, Chairman Johnson. Madame Chairman, distinguished members of the committee, and honored guests, my name is Scott Shipman, Senior Manager-Government Affairs, for the firm of Shipman, Maison & Associates, Ltd. Our firm, based in Chicago, Illinois, is a tax/financial services firm.

Our firm, through its CEO, has been involved with the Targeted Jobs Tax Credit (TJTC) program since its creation in 1978, and while we support modification and extension of the program, we bring a unique perspective on *how* to more economically administer the TJTC program through the use of software technology. This, while simultaneously providing the state agencies with the ability to offer more services to their community.

Madame Chairman, our firm suggests modifying the administration of the TJTC program by the use of a software system, capable of fully administering a State or Federal TJTC program. This system has been tested on a pilot basis in our home state of Illinois. The system manages administration of the TJTC program faster, more efficiently, and more accurately, as it helps the state focus on servicing the applicant and employer communities at less cost to the taxpayer. We do not mean to suggest that the various states relish not being able to respond even faster, they don't, they merely lack the resources which limit their production and effectiveness. Essentially, a software system would do for the TJTC program that which ATM's have done for banking - provide faster service at less cost.

Specifically, this system manages the TJTC program by systematically organizing the TJTC process, starting with the state's ability to issue a certificate in less than 10 minutes, through *initiating* employer/community services rather than *reacting* to demands made upon them. This improvement in TJTC administration gives the local employment office the strength to serve its community, to more efficiently provide "employee pools" of TJTC qualified workers for job placement, consistent with the original intent of the TJTC legislation in 1978. This enhanced service increases employer participation in this and other programs offered by the local employment office, increasing the local office effectiveness and reducing the cost to operate same. For example, the system would complement the concept of the Department of Labor's "one-stop shopping" program, the Department of Naturalization and Immigration's I-9 administration, and the Jobs Training Partnership Act (JTPA). All with less staff than currently exists, resulting in less cost to the taxpayer.

The Illinois Department of Employment Security (IDES) has tested this software system on a pilot project basis, and on a more limited basis, by the state of California's Economic Development Department (EDD). In the areas where the software was used, IDES has been able, with less staff, to respond to employers needs by being able to more accurately and more efficiently process TJTC applicants and satisfy the information needs of the employers, while simultaneously reporting data to the Department of Labor (DOL). Additionally, DOL using existing forms from their ET Handbook 377 and the system we propose, would have accurate, statistical data totaled daily, and available for review and analysis. Again, the cost to the taxpayer would be far less than that which is currently in existence.

I would like to thank you for giving this program the attention it deserves, and for the opportunity to address these issues in this forum. Obviously the technology we suggest to modify the administration of the TJTC program is far more extensive than can be covered in the time allotted today. Accordingly, we have summarized our position in the text of our written testimony. I invite you to review our written testimony, as you may find it informative. Should you or the committee have any questions regarding my testimony, I would be more than happy to try to answer them at this time.

Overview

Essentially, in order to administer the TJTC program, a local employment office is responsible for the identification, verification and certification of an applicant, and "refer" the applicant to an employer for job placement. Our intent herein is to analyze each aspect of TJTC administration, and provide examples of comparing/contrasting local office activity with/against that which can be by utilizing software systems. The service aspect of administration is very important, as many office staffs are overburdened with current workload, hence, slow to respond to the needs of the community employer regarding TJTC certified applicants' jobs placement. With computer software, the exact opposite would be the creation of larger TJTC qualified "pools" - as was the design in 1978.

1.) Identification

The identification process is the first step in determining which applicants are eligible for TJTC certification. Eligibility determinations are made based on an applicant's membership in one of the nine targeted groups, generally: those receiving some sort of welfare or state aid, those who have been to vocational rehabilitation programs, those who have served in the military between 1964 and 1975, young adults between the ages of 18-23, years old, or are 16 or 17 years old at the time of hire, (summer youth category), those applicants convicted of a felony, or those applicants who are in a cooperative education program.

Currently, when an applicant visits a local employment office, the applicant must first complete a form, and "register" with that office before TJTC screening can begin. Naturally, completing forms, (all manually) and registration creates long lines with potentially slow service, and is subject to local custom.

Through the use of technology, software systems offer: on-line access to information, easy, and uniform targeted group identification, and standardization of service.

- o On-Line Access: Software can be linked with other state and federal agencies to provide comprehensive information.

- o Target Group Identification:
  All questions used to interview an applicant are on screen. A simple "Y" for "Yes" entry will identify the correct target group.

- o Standardization:
  The screening process eliminates pre-screening forms for the applicant to complete. Questions concerning the nine targeted categories are on the screen before the interviewing officer and are worded to standardize the entire interview hence not left subjectively to the interviewer.

Through the use of software, eligibility determination can be reached in two minutes or less, per applicant. Local offices not having software available take much longer.

2.) Verification

The second step of TJTC administration involves verification, i.e. the vouchering process. Verification means that once an applicant is identified as a member of a targeted group, the applicant must provide specific documentation evidencing eligibility in a particular target group.

Once the local office verifies that the documents prove that the person is a member of a targeted group, the office will issue a voucher for the applicant to take to an employer who has job openings. In return for hiring this vouchered applicant, upon certification, the employer may receive a tax credit. Currently, vouchers can take 30 minutes per

applicant to complete, and are often unreadable with carbon copy and/or sloppy handwriting. For those offices with TJTC software, computer data entry takes 1 minute or less, with legible results. Thus, service is greatly enhanced as applicants may now be referred to employer job openings by the local job service office. Since the software is mobile, it can be "loaded" on a notebook computer, or laptop, and set up at a job fair, or other on-site screening. Again, this service enhances local office involvement in the community.

3.) Certification

The third and final step in TJTC administration is the issuance of the certificate. This document evidences that the applicant is a member of a targeted group, and once this applicant has worked for an employer for the required period of time, the employer may take a tax credit of 40% of the first $6,000 of the members' qualified wages. At the local office level, the steps necessary to issue a certificate may take 15, 30, or 45 minutes or longer to complete, whereas with a software system, certification is issued at the touch of a button.

The local office address, applicant address, date, social security number, etc. is automatically recorded and stored as a result of the initial screening or registering process. The local office official needs to sign and date the certificate, then mail it to the employer. Again, because the system is mobile, the software may be set up anywhere there is an electrical outlet, and the local office will be in service. This entire process from registration to certification is done in less than 10 minutes, and there is no duplication of data entry upon return to the office.

4.) Reporting

All local employment offices need to report TJTC activity to a central state office, for monitoring, and reporting to regional and DOL offices. At the local office level, it currently takes *hours* to compile the quarterly report and includes running the risk of errors which require additional hours to reconcile. Each level of "roll-up" again requires innumerable hours to compile. Utilizing software, the entire quarterly data is accurately compiled *daily* and reported, with the touch of a button.

Real world examples drive the need for a software system. Many employers or employer representatives call the local and state employment offices to inquire about the status of a person sent in for TJTC determination, or call about the status of the certification. This checking is extremely time consuming for the local office, particularly if the request is (as often the case) more than 2 years old. Because of the volume, the local office staff person has to stop current processing, and manually retrieve stored files to find the information. Some states have to shut down the entire process when conducting status searches. Hence, quite naturally, the states are reluctant to perform the search until a more opportune time, thus creating additional bottlenecks and more employer questions. With the software system, a simple entry of the applicants' social security number would retrieve the answer immediately.

Recently, a local employment office had two opportunities to use the software system. In one instance an employer inquired as to the number of individuals the office had interviewed, and of those interviewed, the number of those individuals determined to be TJTC eligible. The local office was able to give this employer complete reports, by target group, in less than 5 minutes. By contrast, a local office had three employment officers servicing applicants manually, while another officer used the software system. At the end of the day, each officer reported totals. The three officers who serviced applicants manually were still accumulating totals, while the officer with the software was finished, had accurate data, with no need to reconcile errors.

Additionally, officers utilizing a manual process have to return to their office, prepare and record the appropriate vouchers and mail them to the employer for the appropriate employer signature, receive the vouchers in return from the employer then prepare certificates and mail to the employer. Officers utilizing software may issue vouchers and certificates on site, thus permitting the employer to allow the eligible employee to go to work not needing to return to the local job service office for additional information. This simple step encourages local participation by the employer of other state services and programs.

Comparison: Manual Versus Software TJTC Administration

To review, basic TJTC administration involves identifying who is eligible for the program, verification as to being a member of a target group, and certifying the individual for the employer. The following is a chart contrasting the speed, accuracy, and ability of the current local employment office (manual) procedure versus a software based system:

Identification

Manual	Software
Screening: 5-10 Minutes	2 Minutes or Less
Register: By Paper	Electronically
Other Data: Calling other Agencies	Database
Questions: Subjective, by locale	Objective

Verification

Application: Paper, with Carbon Copies	Electronically
Time: 10-30 minutes by hand	1-3 minutes
Accuracy: Varies, by locale	Objective

Certification

Application: By Paper, Typed	Electronically
Time: 15, 30, 45 Minutes or more	Seconds
Accuracy: Variable	Total

TJTC federal funding is proportional to the number of certificates issued. The funds received for the TJTC program does not cover the full cost necessary to administer the program. Therefore, time is taken away from other employment security office duties, including job placement. By computerizing the TJTC process, the local office could consider scheduling opportunities to address other areas of responsibility and possibly provide even more service to the local community such as job placement "pools", hence, once more, getting back to the original intent of the TJTC program.

Conclusion

Our testimony will close with some recommendations and a final thought regarding the TJTC program.

To Modify The TJTC Program:

- o Extend the program for at least 6 years.
- o Offer a credit for 2 years - 25% first year, then 75% second year, to encourage retention.
- o Set the minimum salary to qualify at $6 per hour.
- o Reinstate 23 and 24 year olds as a targeted group.
- o Make all veterans an eligible target group.
- o Add a targeted group to include those over 55 years old.
- o Add a targeted group to include those who have exhausted unemployment insurance benefits.
- o Eliminate the Letter of Request, and issue certificates for individuals hired through the State Employment Service Agency (SESA).
- o Allocate funding for automation.
- o Increase funding for advertising the program. Comments from employers who have "heard something" about the program still leaves a lot to be desired.

The TJTC program has provided an incentive for employers to hire the disadvantaged. While modifications are necessary and appropriate to enhance the program, administration of the program needs to be improved. Current technology is available to help assist the local office in providing a complete service to the community so that all who seek jobs will be referred to an employer who has openings. Through software, the local office will be able to reassert its position in the community, rather than be just the alternative for those seeking employment. A software system would benefit the employer, the applicant, and the local office by saving each of these entities time - of which, in the business world, there is never enough.

Chairman JOHNSON. Thank you.

One way to crystalize this issue, perhaps, since this is the last panel that will testify on the targeted jobs tax credit is, is it more efficient, more effective, and fairer to provide the benefit to the employer, to hire this kind of applicant, and presumably provide the support and training that they need?

Is it fairer to that applicant, and better policy, to provide a skill grant or a training grant so that they can develop the needed skills or learn proper on-the-job work habits, giving them a better choice of employers?

Really, in this group, it is not a question of whether we subsidize this group or not. We really understand that we have to subsidize this group.

The question is, do you do it more effectively by providing the employer a break, or by, in a sense, bringing that person into the general job training, skill development program, that States make available? Briefly, because we do have several more panels, could you comment briefly on that larger issue.

I can see a lot of work has gone into the restructuring proposal. I would just point out to you, Mr. Hubbard, that the eligibility criteria, at least in this brief summary, says veterans who are either currently receiving or have received public assistance in the 18 months prior to hire.

Mr. HUBBARD. That is correct.

Chairman JOHNSON. It is a very limited focus on very low-income veterans?

Mr. HUBBARD. That is correct.

Chairman JOHNSON. OK. Thank you. I just wanted to be sure you were aware of that.

Mr. HUBBARD. That is correct. With respect to training grants as opposed to subsidizing an employer, I agree with the previous comment, that business does it better.

Business is in a much better position to know exactly what kinds of skills they need, then to recruit people and train them in those skills.

Chairman JOHNSON. Thank you.

I yield to Mr. Portman.

Mr. PORTMAN. I thank the Chairwoman. I assume you heard the dialog from the previous panel, and that you might suspect I have some of the same questions for you all.

First of all, thank you for being here and sharing your insights with us.

I would say in response to Ms. Oven saying that—I think your quote was, "this is a perfect fit with regard to welfare to work." I would disagree with that.

I think it is not a perfect fit, when you have, again, the kind of evidence that I have seen, whether it is the GAO report, the Inspector General's report, the other Department of Labor report, or my own, again, companies back home, who give me anecdotal evidence, which indicates that they would have hired many of these people anyway.

The fact is that many employers—and that probably is not true with regard to Ms. Oven's company or the other companies of people represented here. I would say that from what I know of it—and

I am trying to find out more—that most employers, in fact, who are participating in this program, or at least most of the employees, are hired, as any other employee would be hired, to fill an entry position.

Then, after the employee is hired, to determine whether that employee fits the criteria set forth under the tax credit. If they then fit, the employer can qualify for the tax credit and apply for it.

That seems to me to be quite strong evidence of the fact that these people would have been hired anyway.

And again, I think the Houghton proposal is a leap forward. I think it has some problems with it, but I think we need to target more precisely—if we are doing a welfare-to-work program, let's target those people who are on public assistance.

Why provide, according to the Department of Labor, 92 percent of this subsidy to people who would have been hired anyway, and only 8 percent to those who would not have been? Given the scarce Federal dollars, we have got to be more cost effective, we have got to be more targeted.

I would say to Mr. Hubbard's comments, I agree with you, and I think the Houghton approach does a pretty good job.

It is not just Vietnam-era veterans, incidentally. It also would apply to other veterans. I think that is a good example of a way to target the program more precisely to the problem.

I look forward to working with the panel members. You know much more about this program than I and others who have been involved in it do. You have had good experiences figuring out ways to target the program more precisely to the problem, and not be satisfied with the status quo.

Any comments, Ms. Oven, as to your experience, or how we might target it better with regard to precertification, or other ideas?

Ms. OVEN. Yes, I would be glad to comment.

I am not sure if you are aware, that in order for us to comply with EEO requirements, there are many of the TJTC category questions from the old program that we are not legally permitted to ask until a job offer has been made.

That really limits an employer's ability to know, for sure, whether or not we are hiring a TJTC candidate. About the only way we can know for sure is if we go to a community agency, a United Way agency or something like that, and recruit candidates, which our company does.

Even then, for example, if we recruit from an agency that places persons with disabilities, we can ask that they refer TJTC candidates to us. That is not a guarantee. Our screening for candidates is done after the offer is made to comply with EEO, equal employment opportunity, requirements.

With the new proposal, that issue needs to be addressed as a part of that, because we are talking about protected classes, and no company's legal department is going to let them ask those questions, and take that kind of risk, in violation of the EEOC, Equal Employment Opportunity Commission.

Mr. PORTMAN. I understand the problem, and I think there would need to be some sort of a safe harbor provision, or some way to be sure that people felt comfortable.

I hear from employers, beyond that, that even in areas that might be considered safe under existing EEO law, they are afraid of the possibility of litigation, even if groundless, would then cost them enormous amounts in terms of defending themselves.

They are just not willing to get into it at all, and they would rather just wait and see whether the criteria are met after the fact. But again, that gets to the problem, as I see it with the current program, which is that we are not targeting those dollars as precisely as we should.

Mr. Hubbard, do you have a comment?

Mr. HUBBARD. Yes, Mr. Portman, I do.

With regard to these people being hired anyway, if that were the case, I do not think that the unemployment rate for male veterans between 20 and 35 would be as high as 11.8 percent.

A good many of these people are veterans of the armed forces, who served in the combat arms, who do not have skills that are applicable to the job market, except perhaps for some things about initiative and the work ethic, and those kind of things which they learn in the military.

There is another issue here which these people face, and that is one of certification in some cases. For example, a medic who treated gunshot wounds in the Persian Gulf cannot get a job in Washington, DC, without going back to school, just to treat gunshot wounds. That is another whole issue that we are actively involved in with the Department of Labor.

Veterans do face some rather major hurdles out there, and I am not convinced that employers would hire them anyway, were it not for TJTC.

Mr. PORTMAN. That is a good observation. I think it is, frankly, a further argument for further targeting of the existing program.

Mr. HUBBARD. Perhaps.

Mr. PORTMAN. Mr. Shipman, any comments on our colloquy here?

Mr. SHIPMAN. Congressman, the burden on the States to help process this program is significant. Funding keeps getting cut, and staffs keep getting cut every year.

The lack of continuous legislation is a very big pain to them. They, just as businesses cannot plan, neither can the States.

They need a strong signal, and a financial signal, from this body, on which way this program is going.

It is very hard to take care of applicants when their is no way to provide for them otherwise.

Mr. PORTMAN. That is a good point. I think it holds true for the private sector as well, as you indicate. We need to make this permanent, I believe, or disband it and try something new, and I do not like the idea of the temporary extensions.

I would just ask one more question, I think we have another panel ready to go, and that is, with regard to the screening we talked about, Ms. Oven, assuming we could have some sort of EEO safeguards, do you see a concern with self-certification? In other words, if we do not have documentation from a public assistance agency, or as you indicate, from a United Way agency, and so on, how do we deal with the self-certification matter?

Do you have any thoughts on that? This is really an administrative question, administration of the program. But I see that as one

of the potential problems with the reform that we are talking about.

Ms. OVEN. My understanding is that the new program has identified objective criteria for the proposed categories.

I am not sure that the new program has a self-certification provision. You mean the employees themselves come and say they are TJTC-eligible? I am not aware of what provision the new proposal has for the employee, potential employee to know, unless they are working with an agency such as the United Way agency, that informs them of that.

Mr. PORTMAN. Mr. Hubbard.

Mr. HUBBARD. I do not think the vast majority of people who are eligible for TJTC even know what it means.

Mr. SHIPMAN. Let me just comment further with regard to veterans. There would be a way to certify that that individual qualified, assuming that was one of the criteria as it is in the Houghton approach.

Mr. HUBBARD. People who leave the armed forces these days attend something called Transition Assistance Program. It is run by the Veterans Employment and Training Service at the Department of Labor. In that program, they are told to visit the office at the State employment security agency when they get back home and get ready to look for a job.

The counselors in the State employment security agencies are aware of TJTC. If it comes back into being again, they will begin to ask these people to determine whether they are eligible for TJTC. The system exists.

Mr. SHIPMAN. Congressman, if I may, in the State of Illinois, using a software system, you would have objective criteria throughout the State.

If someone discharging from the military moves back to their hometown and it would be St. Louis on the Illinois side, the questions asked of them, in east St. Louis while they were in Chicago, would be exactly the same. That way you don't have variances by local custom or by State. It would be flat.

Mr. PORTMAN. That is a good point.

I thank you all very much for your testimony and for coming today to give us some insights.

I would now like to call my distinguished colleague from Indiana, Mr. Jacobs.

Mr. JACOBS. Thank you, Mr. Chairman.

I would rather be a neighbor than a colleague, actually, Ohio and Indiana.

Mr. PORTMAN. Well, you are both.

Mr. JACOBS. Thank you.

Mr. PORTMAN. Doubly blessed.

Mr. JACOBS. I appreciate that.

I have come to testify in favor of the bills, H.R. 733 and 734, gifts of appreciated property, and the scheme of it is quite simple. We want to encourage charitable giving, and we can do so by allowing donors to deduct the current market value of the gift to worthy causes.

The law expired or, rather, sunsetted at the beginning of this year, and its effect has been so salutary that it seems logical that it should be extended not only in time, but also in description.

Rather than stock alone, let us say you have a piece of property that might be useful for a foundation to help children or something like that. It has appreciated in value. You could either keep it and let it pass through your estate with, in most cases, no tax incident, or you could make the gift to the foundation and the government would not collect tax on the appreciation, but on the other hand, the government never would have got the tax, anyway. Cost is roughly $57 million per year, and obviously, I think it is in the public interest to work very well.

Here is the surprise of the day. That is it.

Mr. PORTMAN. I thank my neighbor, as well as a colleague.

I have to recuse myself here perhaps. My wife was at one time an employee of a private foundation which suffered under not knowing whether these extensions would occur, and I would tend to be quite biased in favor of your proposal.

Let me ask you a couple of questions, though, with regard to how this might work. As a general rule, right now to other 501(c)(3)s, it is my understanding that you do get the market value and not the cost basis, but with regard to private foundations, there is a distinction. Is that correct?

Mr. JACOBS. I am sorry, Rob. I didn't quite—

Mr. PORTMAN. With regard to a contribution to a 501(c)(3), say, a social service agency or some other charitable gift, you would be permitted to get the market value of your publicly traded stock as compared to your cost basis.

Mr. JACOBS. Yes, that is correct, and that has been the law for some time. Unfortunately, it was set up in a way that it would sunset.

I don't know of any serious complaints about it. It has worked pretty well.

Mr. PORTMAN. Let me ask you if you know what percentage of gifts to private foundations are now made in the form of publicly traded stocks. Do you have any sense of that?

Mr. JACOBS. The answer to your question is not complicated. No, I do not know.

Mr. PORTMAN. OK.

Mr. JACOBS. I know that, generally, when the law was not in effect, there was a serious diminution of contributions, and when it was reenacted or enacted, there was an increase, but I can't tell you exactly what percentage that is.

By the way, I should say that Mr. Camp is my cosponsor or I am his cosponsor. We are partners in this thing.

Mr. PORTMAN. You would be full partners.

With that, I will return to the Chairwoman to ask you further penetrating questions.

Mr. JACOBS. Good for you. Don't you love it how people dance all over the lot, "Madam Chair," this and that?

Mr. PORTMAN. I never know whether to call her "Chair," "Chairwoman," or "Madam Chair."

Mr. JACOBS. If it is "Mr. Chairman," why isn't it "Ms. Chairwoman"? Did we ask that today?

By the way, may I say one other thing? My sister used to say when people addressed her as "Madam," generally solicitors, and salespeople, she would always say—and I haven't the slightest idea what this meant, but she would always say, "Don't call me 'Madam.' I just work here." Now, I don't know what that meant.

Chairman JOHNSON. Dave Camp did testify earlier and mentioned that you were in this together, and we do appreciate that bipartisan support, frankly, that is a very important little provision that we do have to consider, thank you for your testimony.

Mr. JACOBS. Thank you, and I appreciate the indulgence of the Committee, even for the dull humor.

Chairman JOHNSON. The next panel is Willie Brown, medical records clerk of the Hampton VA Hospital; Paul Speranza, the secretary and general counsel of Wegmans Food Markets, Rochester, New York; and Frederick Hunt, president of the Society of Professional Benefits Administrators, on behalf of the American Society of Association Executives.

We will start with Mr. Brown, and you will observe the lights, if you please, as we have two more rather long panels after this.

STATEMENT OF WILLIE BROWN, MEDICAL RECORDS CLERK, HAMPTON VETERANS ADMINISTRATION HOSPITAL, HAMPTON, VIRGINIA; ON BEHALF OF THE SECTION 127 COALITION

Mr. BROWN. Good afternoon, Madam Chairwoman and Members of the Subcommittee.

I am pleased to testify on behalf of the Section 127 Coalition in support of the permanent extension of section 127 of the IRC, Internal Revenue Code.

The Section 127 Coalition is a diverse group of businesses and their associations, labor organizations, educational institutions, and human resource experts that are committed to making section 127 a permanent part of the Tax Code.

My name is Willie Brown, and I am a medical records clerk at the Hampton Veterans Administration Hospital in Hampton, Virginia. In addition, I am also a student at Thomas Nelson Community College, also in Hampton.

Quite simply, section 127 is what makes my education possible. I support a family. I am married and have three children. Section 127 allows me to receive up to $5,250 a year in tax-free reimbursements from my employer for tuition, books, and fees for education and training that is not job related.

I am nearing the completion of my associate's degree in public administration, and I hope to continue my education at Christopher Newport University in Newport News, Virginia.

Many of my courses are not purely related to my current job. If I had to pay Federal, State, and local taxes on this benefit out of my pocket, I just couldn't do it.

As president of the Thomas Nelson Community College Student Council, I know that many students are in the same position. Indeed, many are economically disadvantaged. Students have had to stop taking classes when section 127 has expired from time to time. They simply cannot afford to see their already small paychecks further reduced by the tax they would have to pay if they take these

classes, and I understand that this Committee is considering whether or not section 127 should be made a permanent part of the Tax Code.

In reading the history of this issue, it appears that this Committee and Congress originally enacted section 127 for several reasons. Specifically, according to the explanation of the 1978 bill, section 127 was passed because prior law gave rise to an inequitable administration. In addition to the complexity of the tax system, it may have acted as a disintentive to continuing education, particularly among those at the lower end of the economic scale, and those same reasons, they still exist today.

I see much in the news these days about efforts to get the IRS out of citizens' lives. Section 127 does just that by eliminating bureaucratic questionings about whether a class is job related or not. More importantly, section 127 promotes upward mobility among the work force. Yet, it is largely funded by employers, not the Federal Government. Employers provide these benefits to their employees because they see a return on the investment of the employee's education. With additional training and education, these same employees will be able to take on more complex tasks and assume more responsibility. At the same time, numerous studies have shown that education continues to be the ticket to higher earnings.

According to the Bureau of Census, the mean annual earnings of a high school graduate is $18,737. For those with an associate's degree, the mean annual earnings rise to $24,398. College graduates have a mean annual earnings of $32,629. In essence, by enabling employers to provide tax-excludable education to relatively low-paid workers, Congress is ensuring that these workers will use that education to do better work, increase their salaries, and pay higher taxes.

Making section 127 permanent would mean that the Federal Government is encouraging upward mobility. Indeed, you will be promoting a higher standard of living and making work more rewarding by permanently extending section 127.

I would also note that there are even more compelling reasons to make section 127 permanent now than there were when the law was first changed in 1978.

Today, workers change jobs more frequently. There is more international competition, and rapidly changing technology requires a more-skilled and a more regularly trained work force.

Last, as you may know, Coopers & Lybrand completed a study in 1989 of Federal data to determine the characteristics of the beneficiaries of section 127. In that study, nearly 99 percent of section 127 recipients earned less than $50,000. Seventy-one-percent earned less than $30,000, and 36 percent less than $20,000.

Several weeks ago, the Department of Education released the data necessary to bring the study up to date. That update is underway, and a revised study will be provided to this Committee as soon as it is complete.

Madam Chairwoman, I am appreciative of the opportunity to testify before you on this matter.

Chairman JOHNSON. Thank you, Mr. Brown. Your testimony is very helpful.

I would like to recognize Mr. Speranza now.

STATEMENT OF PAUL S. SPERANZA, JR., CORPORATE SECRETARY AND GENERAL COUNSEL, WEGMANS FOOD MARKETS, INC., ROCHESTER, NEW YORK

Mr. SPERANZA. Thank you.

Good afternoon. I am Paul Speranza, and I am corporate secretary and general counsel for Wegmans Food Markets, Inc., which is headquartered in Rochester, New York.

I want to thank you, Congresswoman Johnson, Members of the Subcommittee, and staff for the opportunity to speak to you today on behalf of Wegmans.

Because of our extremely positive experience with the Wegmans scholarship program, we strongly urge you to permanently extend the exclusion for employer-provided educational assistance, pursuant to IRC section 127, through the bill presently before Congress, submitted by Congressman Levin on January 4 of this year. That is entitled Employee Educational Assistance Act of 1995, which, coincidentally, is H.R. 127 or through any other appropriate legislative vehicle.

Wegmans employee scholars have been taking advantage of section 127 since 1984. Since the Wegmans scholarship program began in 1984, Wegmans has awarded over $25 million in scholarships to over 7,200 employees.

Wegmans spent $4 million in 1994 on 2,230 current employee scholarship holders, and Wegmans plans to add another 700 new scholarship recipients in 1995.

Wegmans receives a tax deduction for these expenditures whether they are considered compensation to the scholarship recipient or a scholarship benefit under section 127. Hence, our concern is purely for the financial welfare or our employees and others similarly situated throughout the United States.

Scholarships are awarded to employees who demonstrate excellent work performance, above-average academic achievement, and these two factors account for 50 percent of the decision to award a scholarship. The specifics of the program are set forth in my written testimony.

Section 127 helps people help themselves. Beneficiaries of section 127 are better educated. Hence, they can help themselves. Once educated, these people will have substantially greater earning power and, therefore, pay higher taxes of all kinds, income tax, property tax, sales taxes, and so forth, throughout their lives which will more than offset the tax exemption received under section 127.

Further, making the exclusion permanent is critically important. Parents and college students are on extremely tight budgets. Without a permanent exclusion, they can't financially plan. This exclusion has been extended numerous times, making the administration of a scholarship program extremely difficult.

Trying to explain to over 2,000 families why the dollars they thought they had are no longer there is very difficult. Explaining how to apply for a refund after the fact is also very difficult; for example, 6 pages of forms and instructions as to how to go about doing that. This leaves a very negative impression of our representatives in Washington.

Wegmans has always placed a premium on education at all levels. This scholarship program is just one of several programs it

sponsors through large donations of money, and the donations of money and time of many of its employees. These programs are key elements of Wegmans' success.

Wegmans employs approximately 24,000 individuals. According to the New York State Department of Labor, it is listed as one of the top 10 private employers in New York State.

In a front-page article in The Wall Street Journal on December 27, 1994, which favorably described Wegmans, one nationally renowned industry expert stated, "We consider them," meaning Wegmans, "the best chain in the country, maybe the world."

The television show "Wall Street Week" did a followup piece on its weekly national television show which featured a Wegmans scholarship winner describing the importance of his scholarship. He stated that he could not afford a private education without Wegmans' help.

Wegmans has always been in the forefront of providing top wages, benefits, and working conditions for its employees and has been nationally recognized for its efforts. Some of Wegmans' honors include being named by Fortune magazine as the best supermarket retailer in America in serving its customers.

Being included in the recently published book entitled "The 100 Best Companies to Work for in America."

Being recognized by Working Mother magazine for the fifth consecutive year as one of the best 100 companies for working mothers in America.

Receiving a Point of Light Award by President Bush for having the best corporate charitable program in America, the Work Scholarship Connection Program assists economically disadvantaged youth; being named the top produce retailer and top deli trendsetter, and being recognized as having the best video departments in America by various industry publications.

Section 127 has been an integral part of many of Wegmans' success stories. Wegmans is successful because of its motivated and educated work force. If Wegmans can do this, so can others.

A permanent exclusion for employer-provided educational assistance makes it much easier for all American businesses to educate its employees. It is only through education that Americans can maintain and improve its status in the world economic community.

Thank you.

[The prepared statement follows:]

PAUL S. SPERANZA, JR. ON BEHALF
OF
WEGMANS FOOD MARKETS, INC.

May 9, 1995 Subcommittee on Oversight Hearing of the Committee on Ways and Means - Exclusion for Employer-Provided Educational Assistance (Code Section 127)

Good afternoon, I am Paul Speranza. I am Corporate Secretary and General Counsel for Wegmans Food Markets, Inc. which has its headquarters in Rochester, New York. I want to thank you Congresswoman Johnson, members of this Subcommittee and staff for the opportunity to speak to you today on behalf of Wegmans Food Markets, Inc. Because of our extremely positive experience with the Wegmans Scholarship Program, we strongly urge you to permanently extend the Exclusion for Employer-Provided Educational Assistance pursuant to Internal Revenue Code Section 127 through the bill presently before Congress submitted by Congressman Levin on January 4, 1995 entitled "Employer Educational Assistance Act of 1995" which coincidentally is HR 127 or through any other appropriate legislative vehicle.

Wegmans Food Markets, Inc. employee scholars have taken advantage of Section 127 since 1984. Since the Wegmans Scholarship Program began in 1984, Wegmans has awarded over $25,000,000 in scholarships to over 7,200 employees. Wegmans spent $4,000,000 in 1994 on 2,230 current employee scholarship holders, and Wegmans plans to add another 700 new scholarship recipients in 1995. The program pays 50% of tuition up to a maximum of $1,500 per academic year. Wegmans receives a tax deduction for these expenditures whether they are considered compensation to the scholarship recipient or a scholarship benefit under Section 127, hence, our concern is purely for the financial welfare of our employees and others similarly situated throughout the United States. To be eligible, employees must be continuously employed for at least 21 months by the time they plan to use the award and they must work an average of ten hours per week. Scholarships are awarded to employees who demonstrate excellent work performance, above average academic achievement, and these two factors account for 50% each of the decision to award a scholarship. There are no restrictions on fields of study. Winners are required to work 300 hours per year to be eligible to renew their awards and scholarships are renewable for up to a total award of four years. Winners must continue to demonstrate excellent work performance, and they are reviewed annually by their supervisors. An independent agency judges the academic portion of the scholarship application by using a committee made up of varied experts in the field of education. A committee of store managers judges the work performance portion of the scholarship application based on performance appraisals submitted by the applicant's department manager and store manager.

Internal Revenue Code Section 127 helps people help themselves. Beneficiaries of Section 127 are better educated, hence they help themselves. Once educated, these people will have substantially greater earning power and therefore, pay higher taxes of all kinds (income, real property, sales, etc.) throughout their lives which will more than offset the tax exemption received under Section 127. Further, making the exclusion permanent is critically important. Parents and college students are on extremely tight budgets. Without a permanent exclusion, they cannot financially plan. This exclusion has been extended numerous times, making the administration of a scholarship program extremely difficult. Trying to explain to over 2,000 families why the dollars they thought they had are no longer there is very difficult. Explaining how to apply for a refund after the fact is also very difficult. This leaves a very negative impression of our representatives in Washington.

Wegmans Food Markets, Inc. has always placed a premium on education at all levels. This scholarship program is just one of several programs it sponsors through large donations of money and the donations of money and time of many of its employees. These programs are key elements of Wegmans' success. Wegmans Food Markets, Inc. employs approximately 24,000 individuals. According to the New York State Department of Labor, it is listed as one of Top Ten Private Employers in New York State. In a front page article in The Wall Street Journal on December 27, 1994 which favorably described Wegmans, one nationally renowned industry expert stated, "We consider them (Wegmans) the best chain in the country, maybe the world." The television show "Wall Street Week" did a follow-up piece on its weekly national television show, which featured a Wegmans' scholarship winner describing the importance of his Wegmans Scholarship. He stated that he could not afford a private college education without Wegmans' help. Wegmans has always been in the forefront of providing top wages, benefits, and working conditions for its employees and has been nationally recognized for its efforts. Some of Wegmans' honors include being named by Fortune magazine as the Best Supermarket Retailer in America in serving its customers, being included in a recently published book entitled, The 100 Best Companies to Work for in America, being recognized by Working Mother magazine for the fifth consecutive year as one of the Best 100 Companies for Working Mothers in America, receiving a Point of Light award by President Bush for having the Best Corporate Charitable Program in America (the Work Scholarship Connection Program assists economically disadvantaged youth), being named the Top Produce Retailer and Top Deli Trendsetter, and being recognized as having the Best Video Department in America by various industry publications. Section 127 of the Internal Revenue Code has been an integral part of many of Wegmans' success stories. Wegmans is successful because of its motivated and educated work force. If Wegmans can do this, so can others. A permanent exclusion for employer-provided educational assistance makes it much easier for all American businesses to educate its employees. It is only through education that America can maintain and improve its status in the world economic community.

Chairman JOHNSON. Thank you, Mr. Speranza.
Mr. Hunt.

STATEMENT BY FREDERICK D. HUNT, JR., PRESIDENT, SOCIETY OF PROFESSIONAL BENEFITS ADMINISTRATORS; ON BEHALF OF AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES

Mr. HUNT. Good afternoon. My name is Fred Hunt. I am president of the Society of Professional Benefits Administrators, but today I am speaking for an even larger constituency, and that is the ASAE, American Society of Association Executives, where I have served as a volunteer on the government affairs and the insurance industry committees.

ASAE is a not-for-profit, tax-exempt, umbrella organization, organized to serve and represent association executives such as myself. ASAE's membership includes about 22,300 association executives as well as suppliers of goods and services to the association community. Approximately one-third of ASAE's association executives manage charitable and philanthropic organizations. The remaining two-thirds manage professional societies and trade associations.

The more than 10,400 associations, including many that you have heard from today in this room, are managed by ASAE members which include international, national, regional, State, and local associations, as well as multitiered federations. At one point, we added up to see what is the constituency, and we discovered it was about 287 million people, which is pretty good. It obviously shows that there is overlap in this country, but it shows that almost every American gets touched by the association community.

Let me add, parenthetically, that this is really a threefold testimony. You are really getting three different perspectives.

Most association executives such as myself are employees, and thus, we can tell you from an employee point of view in a field where continuing education and new fields is very important. Most of us are employers. We employ people, and so we know what we are looking for, what we want to hire.

Third, associations, much like yourselves, end up being clearinghouses. When people have complaints, when there are trends, when there are needs, they come to us, just as you have heard most of the testimony today. It has been on behalf of associations.

Please look at this as really three testimonies in one. Fortunately, they all three agree.

ASAE is testifying today on behalf of the many organizations it represents, virtually all of whom have a keen interest in the reinstatement and continuation on a permanent basis of IRC section 127.

As such, ASAE strongly urges Congress to permanently extend section 127 of the IRC providing an exclusion from income for the value of the employer-provided education assistance.

As you know, the important provision expired on December 31, 1994, and with it went the hopes of many middle class and, I would say also, senior executives. Many industries are changing today, as well as, of course, the lower income. This is an across-the-scale issue.

Associations and other employers will also suffer if this provision is not extended. They use section 127 as a valuable retraining tool within their industries for workers who lose jobs or whose jobs have become obsolete. In short, section 127 helps associations, businesses, and workers develop the skills they need to compete in today's changing global economy.

Specifically, section 127 allows employers, including associations, to provide up to $5,250 per year to each of their employees in tax-free reimbursements for tuition, books, and fees that are not directly related to their job.

Congress has continually affirmed its support for this program since its inception in 1978. Since then, more than 7 million Americans have been able to work and attend classes in order to improve their skills and quality for better jobs. These individuals are from large, medium, and small associations, companies, and other employers throughout the country.

The section 127 program is the only way that many millions of working men and women can contribute to further their education while they perform their responsibilities to their families, employers, and hold down their jobs.

Continuing education is a vital factor in the growth and promotion of America's work force, and I would say you have heard a number of good things; to summarize, seeing the light.

Mr. Portman had a good point that these things pay, and I think you should look at this section 127 as a revenue raiser. This is going to generate money. You have heard all three of us mention there is a direct correlation. More education means more income which means more income taxes, and for that $5,250 that somebody may get, they may learn how to use a computer. They may learn how to get a college degree, whatever it may be. These are the things that will allow them to go up, and we have spent lots of money, certainly, throughout saying education means better jobs. I think this is a revenue raiser. It is an investment rather than an expense.

The ASAE thanks you very much, and I hope you will look at the written record for more thorough recommendations that we have to offer today.

[The prepared statement follows:]

STATEMENT OF FREDERICK D. HUNT, JR.
ON BEHALF OF
THE AMERICAN SOCIETY OF ASSOCIATION EXECUTIVES (ASAE)

Good afternoon. My name is Frederick D. Hunt, Jr. and I am President of the Society of Professional Benefits Administrators (SPBA). I am testifying this afternoon on behalf of the American Society of Association Executives (ASAE), where I serve as a volunteer on the ASAE Government Affairs Committee.

ASAE is a not-for-profit, tax-exempt, umbrella organization organized to serve and represent association executives. ASAE's membership includes approximately 22,300 association executives, as well as suppliers of goods and services to the association community.

Approximately one-third of ASAE's association executives manage charitable and philanthropic organizations; the remaining two-thirds manage professional societies and trade associations. The more than 10,400 associations managed by ASAE members include international, national, regional, state, and local associations, as well as multi-tiered federations and coalitions.

If you count up the memberships of all organizations which have representation in ASAE, more than 287 million individuals, companies, churches, universities, and other types of groups are represented. Of course, this figure includes many duplications, since many individuals and companies belong to more than just one association — but it illustrates the magnitude of how Associations Advance America.

ASAE is testifying today on behalf of the many organizations it represents, virtually all of whom have a keen interest in the reinstatement — and continuation on a permanent basis — of IRC Section 127. As such, ASAE strongly urges Congress to permanently extend section 127 of the *Internal Revenue Code*, providing an exclusion from income for the value of employer-provided education assistance.

As you know, this important provision expired on December 31, 1994. With it went the hopes of thousands of middle-class employees who use these benefits to attend school and further their education.

Associations, businesses and other employers will also suffer if this provision is not extended; they use section 127 as a valuable retraining tool for workers whose jobs have become obsolete. In short, section 127 helps associations, businesses and workers develop the skills needed to compete in today's changing global economy.

Specifically, section 127 allows employers, including associations, to provide up to $5,250 per year to each of their employees in tax-free reimbursements for tuition, books and fees for non-job-related education.

Congress has continually affirmed its support for this program since its inception in 1978. Since then, more than seven million Americans have been able to work and attend classes in order to improve their skills and qualify for better jobs. These individuals are from large, medium and small associations, companies and other employers throughout the country. The section 127 program is the only way that many millions of working men and women can continue to further their education while they perform their responsibilities to their

families and employers, hold down their jobs, and enhance their own skills for the constantly changing workplace.

Continuing education is a vital factor in the growth and promotion of America's workforce. It enables individuals to broaden their skills and knowledge and keep pace with changing technology.

Government statistics tell us that the majority of U.S. workers now have less than four years of high school, yet nearly two-thirds of all new jobs in our economy will soon require more than a high school education. America must deal with this problem quickly. And one means of answering this dilemma is to provide an incentive to individuals and employers to making a permanent commitment to life-long education.

Section 127 education assistance benefits are a prudent and economically sound investment in the American workforce. Nobody can disagree that continuing education and training of the U.S. worker are fundamental to meeting the challenges of the global economy, and enabling our nation to compete effectively against formidable competition.

Why should America's associations be so concerned about Section 127 extension? Because we are both employers as well as "servants" of our own memberships, i.e., the myriad of trade and professional organizations which rely upon the educational infrastructure as the backbone of our economic health and progress.

Virtually all associations have a vital stake in insuring that our members — whether they are individuals, corporations, universities, or other types of organizations — are able to continuously educate their employees in their own unique ways.

According to the key study entitled ***The Value of Associations to American Society,*** jointly conducted by the Hudson Institute, the American Society of Association Executives, and the ASAE Foundation, associations are now more deeply immersed in education than in any other activity, save conventions. Even this statistic may be slightly misleading, since most conventions and trade shows are directly related to educational programming and product and technical displays which keep entire industries and professions educated about new goods and services.

Some other reasons for ASAE's strong support of Section 127:

- Association members spend nearly $5.5 billion annually to fund their own employee and member educational needs and to organize or facilitate industry-specific educational programming.

- According to ASAE's estimates, nearly 90% of associations now offer educational programs and services to members.

- Education-based associations serve the public by improving the technical skills as well as the leadership and management abilities of both members and non-members.

- A very special place for association education is found in translating general discoveries and principles into the concrete requirements of particular industries and professions. This

capacity places association in a leading role to train and retrain the future workforce, and to advance society's needs.

- Association education serves the interests of members by increasing their productivity, enabling them to meet requirements for continuing education, helping to define their profession, and providing an important source of revenue. The public interest is directly related to this self-interest of specific industry and professional groups.

In closing, Mr. Chairman, employee education assistance has been repeatedly embraced by Congress and a majority of U.S. employers as one of the country's proven "competitiveness" policies. And this policy is all about empowerment, private sector initiative, and marketplace dynamics. It is time to make the ***Employee Educational Assistance Act*** permanent law.

Thank you.

Chairman JOHNSON. Thank you very much.

One of the things that you have heard in this hearing is that every extender that we adopt has to be paid for. One of the things that interests me is the structure of the programs and, therefore, their cost.

You can go to evening law school for $3,000 a year, why is it necessary to offer more than $5,000 worth of educational expenses? If someone is working full time, it is awfully hard to build up that amount of tuition cost at the same time. Would you comment on whether this would be a functional program at, say, $3,000?

Mr. SPERANZA. Why don't I start with that. First of all, I am not sure how many law schools you can go to for $3,500, but that aside, I have seen the real benefits of this program and our community in the communities where we do business.

I will give you two examples in my own department, for example. I hired a secretary, a single parent who couldn't afford an education. Secretaries don't make a lot of money, a high school graduate.

Chairman JOHNSON. I don't disagree with you. It is the merit of the program. I have lost people from my staff because I didn't have the ability to do this for them, and they wanted to finish school and they couldn't afford any other way. I see its mobility implications and the power it has to simply allow people to get the education they need that they couldn't otherwise afford, but what are the dollar dimensions of the necessary support?

If you get 3,000 dollars' worth of support for tuition and books and you are working full time, is that enough?

Mr. SPERANZA. All I can say as a practical matter from our experience, it has been enough. Most of our employees are in New York State. We have a good public education system. You can get a college education at a State college, the State University of New York, for example, for a tuition of $2,500. Those dollars are very important, and as I said before, I have seen people who could not afford, who were using every penny to put food on the table for their children.

Chairman JOHNSON. Oh, I agree.

Mr. PORTMAN. They didn't have the opportunity and now they do. They have graduated. I have one particular secretary who got a 4.0 average at a local school, and now she is an executive in our company. She could not have had that opportunity without a scholarship, and we have a number of stories like that.

Mr. HUNT. I would be worried about setting a number, just because numbers end up causing problems. I see your concern, and I think it is a good one.

I think the nice part, again going back to Mr. Portman's thing, is whatever your investment is, whatever the person makes, you are going to see it coming back in taxes, and I know there is some—

Chairman JOHNSON. The number in the law now—

Mr. HUNT. I am sorry?

Chairman JOHNSON [continuing]. The number in the law now is $5,250.

Mr. HUNT. Yes, ma'am.

Chairman JOHNSON. That is a reduction from a higher number that we adopted a few years ago. These numbers are important from the point of view from the Congressional Budget Office estimating the possible cost of this program.

If $3,000 is about as much as anybody really uses anyway and if that will do the job, then we want to bring that number down. That is really what I am asking.

Mr. Brown, do you have any comment on that? Do you know what it cost you per year?

Mr. BROWN. Last year, was about $4,000.

Chairman JOHNSON. That is interesting.

Mr. BROWN. I think limiting the number would sort of limit the opportunities of the schools you could choose.

Chairman JOHNSON. Yes, it does. It would certainly do that. It would focus you on the public institutions—

Mr. BROWN. Right.

Chairman JOHNSON [continuing]. The lower we drop the tuition. That is absolutely true.

Mr. BROWN. I guess the other important part of it is there is a company where I live, and 82 percent of their employees go to my particular community college. The numbers of those employees had dropped off with the expiration of 127, and this company looks for their employees to come to school to help increase their productivity as far as the company is concerned. When those numbers go up or go down, it gets kind of monotonous at times.

Chairman JOHNSON. Thank you very much.

I am going to recognize Mr. Levin of Michigan, and then he will recognize our other colleagues.

Mr. LEVIN. Mr. Portman will come after me.

All right. I will be brief. I think that the distinguished Chair of the Subcommittee has put her finger on some of the problems and the need, and your testimony is so important. I think we have to go in our thinking beyond the days when there was a rigid separation between work and education.

I am finding more and more as I go into plants, for example, the intimate relationship between the workplace and learning the skills and upgrading your skills.

I think this provision is today far more significant than it was when it was passed. In that sense, legislation—it doesn't always happen—was ahead of its time.

Let me ask you, one of the criticisms is that this program benefits too many higher paid workers. What is your experience? Who have been the main recipients? I think the beneficiaries are the companies as well as the workers, but in terms of the participants, what has been your experience, any of the three of you?

Mr. BROWN. If it is beneficial for higher paid workers, especially at my institution, that hasn't happened.

Colling-Myers, which is a furniture company, Chic-Fil-A, which is a fast-food chain, offer $2,000 benefits. They give their employees—who are still making basically minimum wage or maybe 50 to 75 cents more than the minimum wage—give them $2,000 to go to school, and there is a vast number of those that are attending school.

As a matter of fact, I would say that a majority of the 11,000 and some odd students that attend my institution, are in lower income jobs. We are talking $30,000 and below.

Mr. SPERANZA. If I could respond to that question as well, Congressman, in our industry which is the food industry, there are not necessarily well-paid jobs at entry level. The skills they learn at college can get them into some higher paying jobs, but to put it in perspective, when you are talking about $5,000 as an upper limit for help, our program is much less than that.

A private college education today probably costs $25,000 to $30,000. We are not talking the upper end or even the upper middle. You are talking about people who are scraping by, who have no alternative but a community college or a State school, and this covers a good portion of that tuition, not all of it necessarily. We think people should help themselves, also, but that is the group we are targeting. It is the people coming out of high school, the people who are struggling to perhaps try college, people who have lost jobs, career changes, and that sort of thing. We think the target is right on.

Mr. HUNT. I think there is another factor to remember as well. We often talk about highly paid. I heard earlier they were talking about Boeing aircraft, when they laid off umpteen people. You might have been a $100,000 engineer. You just got laid off. You're a zero-dollar engineer, but people are going to say, "You know that $100,000 guy? Well, he needs to suddenly get retrained for something."

Also, I think that there are a lot of stories that are going on now. We are hearing that bank tellers are going to be rare nowadays. There are going to be a lot of major changes in white-collar jobs.

I am 48, and there are a lot of people just a year or two ahead of me who finished college before computers were really known. They have no background. They are going to be stymied. They may be making a lot of money now, but they are hitting a glass ceiling and all that, or if they get laid off, where are they going to go?

Keep in mind when you talk about upper income and all, it may be the income that they are making today, and they may need to be retrained. Be looking at that.

I think it is one of these nice things that we will do. Plus, if that $100,000 former Boeing engineer is reemployed, he is going to be paying pretty high taxes and at the highest tax rate.

I think as you said, it is one of those nice things. It is a win-win for the government and for all segments of society.

Mr. LEVIN. Thank you very much.

Mr. PORTMAN. I think my colleague from Michigan is correct in saying the program, in some respects, was ahead of its time.

Mr. Hunt, you had referred to some of the dialog we had had earlier. I was talking about the white-collar issues in my district and the fact that there is so much transition. I believe now that the typical kindergartner will have 14 careers in his or her life. I think this is an important provision.

I will say, getting back to the fiscal conservative role and our need to target and to streamline these programs, that it is not a perfect program. It could be improved.

One thing that many of us, of course, have thought about, which is consistent with Mr. Levin's question is some kind of means testing. The $100,000 engineer, if he is laid off from Boeing, that is one thing, and he would be receiving unemployment assistance for some period of time, but if he continues at $100,000 a year and is being retrained for a new job, he is still getting $100,000 a year, although his prospects for the job he has are not good. He is being retrained.

Should he receive the same exclusion from income, which is all the more important to him, at $100,000 than it is for somebody making $35,000, the person at the lower level, that is one question I have had of this program. Is there an appropriate means testing in this program? What would that mean for you and others?

Mr. HUNT. I think that one of the things we are seeing today is there is often a big difference. It is not, hot and cold, being fired. There is handwriting on the wall.

I will pick on the poor, old bank tellers again. If I were a bank teller right now, I have not been fired, but my guess is that I don't have a long career ahead of me. That is a shrinking field, and it is the same with a number of different industries as you look around. Things that used to be big, thriving industries are shrinking, senior bank executives being another example.

I think that is one of the things, and perhaps we see it in the association field. Somebody will say, "Yes, I have been in this part of the industry, but gosh, I see the trend is going to be over here." You get to the point, all right, he is making $100,000 today, but he knows that is going to fizzle out in a few years, that whole area of business. He can either ride it down, and then you have got him down here and what to do, and of course, usually it happens when he is at the height of his mortgage and everything else, or you can make it a smooth transition.

I think that there is a factor there, and again, I think it is one of those things that pays for itself in terms of even when the person is at the higher level, he is probably going to get a pay raise if he has got a better education or he has learned about things, how to use computers, or whatever it may be.

One of the nice things that is most cost effective in terms of the association programs is they tend to be very targeted. You may be a college graduate and suddenly find yourself in midlife crisis and don't know what you are doing. You can go and get some specific course through association, and that usually costs a lot less.

Mr. PORTMAN. Your suggestion is that even at the $100,000 level, in the end it is a good bargain for the government to provide some assistance for retraining or additional education because even that person will be a net cost to the government should that person sort of fall off the fast track and end up being in need of public assistance or some other government subsidy?

Mr. HUNT. I think so, but like you, I am a fiscal conservative. I probably just think that is hard to say, and yet, when I kind of think through the math of it, if the person is down for a few years, you are certainly going to see his tax revenues go down. If you go across at that level, you are paying big tax dollars. Common sense kind of walks me through and says it does pay out.

Mr. SPERANZA. I have just one comment.

Mr. PORTMAN. Yes, Mr. Speranza.

Chairman JOHNSON. The anecdote of the $100,000 individual, I think, is quite dangerous.

Mr. HUNT. Exactly.

Mr. SPERANZA. We don't have any $100,000 people in our industry that benefit from this program, nowhere near that. They bag groceries.

I think there may be a person or two, that may sneak through at that level of income, but when we are talking about the people in our industry, which is a very basic industry, we don't see that. If there is going to be a means test and I would prefer that there wouldn't be. It should be done in such a way that you don't have substantial Government intervention and more paperwork which discourages the very people who need the help, I think that would be a key consideration.

Mr. HUNT. That is very valid. That goes to our earlier testimony.

Mr. PORTMAN. Are there any other improvements you could see for the current program? One idea, of course, I guess, under 162, you can take a miscellaneous deduction, an itemized deduction for job-related training currently, and some have argued that this provision isn't necessary because it should be job related and you can go through the paperwork to get the deduction if it is job related.

Do you think that would make any sense to try to have some link to the job?

Mr. SPERANZA. I could speak to that. In our kind of program, absolutely not. For example, what we are trying to do is train people for the future, give them additional skills.

We are starting out at entry level. We have got people in the program who have gone to medical school, to law school, graduate programs, and so forth, but the bulk of them community colleges, State schools, and so on. I wouldn't think that that would be the way to go.

Mr. PORTMAN. Absolutely.

I yield to the gentleman from Michigan.

Mr. LEVIN. I have been thinking about that, and since we have a common interest here, if it would otherwise be covered, I don't think it would be scored as costing or saving several billion dollars. So there must be considerable numbers.

Mr. PORTMAN. Who are not in that category.

Mr. LEVIN. I think so.

Mr. PORTMAN. Yes.

Mr. LEVIN. Otherwise, by abolishing section 127, we would get close to a zero cost or cost savings.

Mr. PORTMAN. I think, if the gentleman will yield back, I think you are correct, and my only question was whether there is an argument for making the section 127 exclusion from income job related, not so much that section 127 would subsume all the activities, but is there a way to narrow the current exclusion and, therefore, have it more targeted? I am not sure I would support that, personally, but I throw that out as an idea for further clarification.

Mr. LEVIN. Thank you.

Mr. HUNT. I think you would find people would be getting into spitting matches constantly with IRS where you would have conservative tax departments of companies.

If one of his baggers, for instance, says, "Gee, I would really like to have his job, to be general counsel of the company some day," and he wants to go to law school, obviously I think the IRS would look and say no way does law school have anything to do with bagging.

I think you would constantly be in a spitting match over that, and this is what I have heard from oldtimers, meaning pre-1978.

Mr. PORTMAN. That also gets to your concern about the cost of the compliance and paperwork in the program.

Mr. HUNT. Or just the general chilling effect that it would have on people, and especially we are talking about looking ahead to changes. There are things that we don't know that are going to happen in, say, the year 2000 that we are probably all have to be retrained for that would not necessarily be job-specific. Is the IRS going to always be on the cutting edge of knowing what is going to be best for me?

Mr. PORTMAN. Right.

Mr. SPERANZA. The bottom line, Congressman, is to allow people to help themselves. You have people at the entry level jobs who are trying to get ahead. If you have job related training only, why would somebody want to get an education to be a better cashier? They want to get into management and so on. For an industry like ours and similar situated industries, it makes no sense.

The last comment I would have is we think the program is so important we would like to keep it just the way it is with the permanent extension, but if that can't be, the second best thing is lowering the amount.

Mr. PORTMAN. The $5,250 amount?

Mr. SPERANZA. Correct.

We would certainly want it the way it is, but I would hate to get rid of the whole program, which is very, very effective, because of the cost constraints.

Mr. PORTMAN. One final question. We now have an official Chairman here sitting in the chair and everything, but, Mr. Brown, your personal experience when you went back to school or went to school, was this directly related to your responsibilities at work or was it to broaden your horizons and get into other areas?

Mr. BROWN. I started off actually in a work study situation. My reasons for wanting to go to school—well, I had ambitions of being a public administrator, basically a medical administrator. I got into a public administration curriculum.

A lot of the courses that I take are basically governmental courses. I have had courses in social work, fiscal administration, you know, different things like that. Of course, you have the other classes that really have nothing to do with that particular job, like your electives and things like that, but for me, it is very beneficial for what I want to do at the VA, Veterans Administration, hospital, or in some type of medical system of being an administrator as opposed to a worker.

I am starting off at the entry level where I work in the Medical Records Department. Basically, I take care of over 1 million records at the hospital. By getting this type of degree, it will help me achieve what I ultimately want to do, and that is to be a public administrator in a medical field.

When I look at the way this Tax Code is, two different entities benefit from this. The hospital benefits because I get more education. I will be able to put more into my job, and eventually as far as promotion is concerned, and the government comes out as well because the more I make, the more taxes I pay.

The local government is a beneficiary as well because the more I make, the better house I may live in or the better neighborhood. My property taxes go up. They are making money, and that is just how I see the whole thing.

Mr. PORTMAN. Thank you all for your testimony. I appreciate it.

Mr. SPERANZA. You are welcome.

Mr. HERGER [presiding]. Thank you very much. We appreciate your testimony. Thank you.

The next panelists will step forward, please. They are Linda Chase, vice president, corporate affairs, Auto Club of Hartford, Connecticut, on behalf of the Society for Human Resource Management; Pamala Easley, payroll supervisor, Vinnell Corp., on behalf of American Payroll Association; Robert D. Williamson, president, American Society for Payroll Management; Stafford E. Thornton, president, American Society of Civil Engineers; and Ross J. McVey, assistant controller, director of tax, Telephone & Data Systems, Inc.

Ms. Chase, if you would begin your testimony, please.

STATEMENT OF LINDA CHASE, VICE PRESIDENT, CORPORATE AFFAIRS, AUTO CLUB OF HARTFORD (AAA), HARTFORD, CONNECTICUT; ON BEHALF OF SOCIETY FOR HUMAN RESOURCE MANAGEMENT

Ms. CHASE. Thank you.

My name is Linda Chase. I am the vice president of corporate affairs for the Automobile Club of Hartford in Hartford, Connecticut, which is an affiliate of the American Automobile Association, also known as AAA.

I am testifying today, however, on behalf of the SHRM, Society for Human Resource Management. SHRM is the leading voice in the human resource profession. SHRM represent the interests of more than 66,000 professional and student members in 435 chapters from all 50 States.

On behalf of SHRM, I wanted to thank you for this opportunity to appear before this Subcommittee to express our support of a permanent extension of section 127 of the IRC.

I would also like to thank Congressman Shaw of the Full Committee and also Congressman Levin of this Subcommittee for all of your work. We do appreciate that support.

I would like to offer for your consideration AAA's approach to human resources, we do place a high value on education, mutual respect, and the shared value of our employees, and we feel that there are no guarantees of success in the business world. However, AAA has found that if we invest in our employees and challenge ourselves to learn, we can achieve a level of service in the motoring, travel, and insurance industry that is unparalleled, and I will tell you why.

The only tool, the only resource that our competitors cannot reproduce is our people. They can build new facilities and they can

pay their workers less and they can take shortcuts in customer service, but our people are unique, and that is what makes AAA a leader in our field.

In the same way, if we are to be a productive and competitive Nation, we must use our limited resources wisely. Section 127 represents the kind of investment worthy of Federal support.

On the average, employees with 4 or more years of college earn 70 percent more than employees with only a high school degree. Higher income leads to increased tax liability, and the government easily recoups its investment over the trained worker's lifetime.

Section 127 is the right tool for the entire business community. Businesses don't just give away money. We provide educational assistance because it helps us attract good workers, keep them, and help them to become even more productive employees, and that is why temporary extensions of 127 have been unsatisfactory. The temporary extension brings about tremendous administrative problems as long-range plans for training are disrupted.

While there is another IRC, section 132, that allows for the narrow exclusion of strictly job related assistance, businesses cannot comply with a standard that requires us to guess whether the IRS will consider it job related every time we send a worker for training.

Limiting our employees to only job related education also restricts employers in their efforts to cross train employees and promote from within.

While education is important for everyone, low-income workers, in particular, rely on employer-provided assistance to improve their career prospects. These employees, who may be hired initially to take care of routine administrative functions, take advantage of section 127 to gain skills for higher paying jobs.

Limiting these workers to job related education only is, in essence, relegating them to training for skills that cannot help them get ahead. The American dream is all about advancing through hard work and education, not just maintaining the same status in the same job.

I am an example of a lower paid, lower income worker that has risen in one particular company because of section 127. At AAA, I have been there for 13 years, and I started coming out of college where I had a very narrow degree. I went to AAA as an entry-level telemarketing representative and became an auto travel counselor. From there, I moved into the public relations field, and I didn't know anything about it. I had to be educated on the job, and my company supported that.

From there, I moved into human resources, and today I am the vice president, after 13 years. I highly support section 127's extension.

Laid-off employees, in turn, are also affected by the loss of section 127. In Connecticut, we have an awful lot of downsizing going on, and through section 127, in some cases, laid-off workers often have the shock of the job loss somewhat lessened when their former companies pay for training for other jobs available in the community that they could assume.

Without section 127, the laid-off employees would be taxed on that training at the very time they have no income and desperately need help in securing another job.

With section 127, on the other hand, our workers have a chance to broaden their educations and prepare for the higher skilled jobs they currently do not have, but are within reach through education.

I would like to thank this Subcommittee for its time today, and I hope that you will continue to call in AAA and the Society for Human Resource Management as you seek to restore and extend the exclusion for employee educational assistance.

Thank you.

[The prepared statement follows:]

STATEMENT OF LINDA CHASE
VICE PRESIDENT FOR CORPORATE AFFAIRS, AUTO CLUB OF HARTFORD
ON BEHALF OF THE
SOCIETY FOR HUMAN RESOURCE MANAGEMENT

Madame Chairman, my name is Linda Chase and I am the Vice President for Corporate Affairs of the Auto Club of Hartford in Hartford, Connecticut, part of the American Automobile Association, also known as AAA. I am testifying today on behalf of the Society for Human Resource Management.

SHRM is the leading voice of the human resource profession, representing the interests of more than 66,000 professional and student members in 435 chapters from all 50 states.

On behalf of SHRM, I wanted to thank you for the opportunity to appear before the Subcommittee to express our support of a permanent extension of Section 127 of the Internal Revenue Code.

SHRM members work for organizations employing over 80 million American workers. SHRM, however, has no corporate members-- only individuals. This protects the independence of our human resource professionals and allows them to continue in their role of being effective liaisons between employers and employees.

As human resource professionals work to recruit, train and retain employees, we hear directly from both employers and employees regarding which programs work. Since we also administer those programs, human resource professionals are uniquely positioned to give balanced input on which are the best and most effective policies in the workplace-- and I can tell you unequivocally that Section 127 works.

I would also like to thank Congressman Shaw of the full Committee and Congressman Levin of this Subcommittee for introducing H.R. 127, legislation that would permanently extend Section 127. We appreciate their work and the support of other members of Congress who have demonstrated their commitment to continuing education by cosponsoring this bill.

Madame Chair, Congress has a difficult job. As elected representatives, we recognize that you are challenged daily to make tough choices. You must weigh options, balance competing interests and make policy judgments based on what is best for the nation.

Although I am not elected to public office, I offer for your consideration AAA's approach to human resources: we highly value education, mutual respect and the shared values of our employees.

There are no guarantees of success in the business world. However, AAA has found that if we invest in our employees and challenge ourselves to learn, we can achieve a level of service in the motor, travel and insurance industry that is unparalleled.

I'll tell you why: The only tool, the only resource, that our competitors cannot reproduce is our people. They can build new facilities, pay their workers less, and take shortcuts in customer service. But our people are unique, and that is what makes AAA a leader in our field.

As part of its training initiative, AAA makes broad use of Section 127, educational assistance. Our workers like it, and I can testify of its impact on our workforce. Educational assistance is one of the tools that AAA uses to make it the company it is today.

In the same way, educational assistance is a key tool for all of America, and Section 127 represents a solid investment for the government. The Bureau of the Census confirms what we already know when it reports that education is the key to higher income. On average, employees with four or more years of college earn 70 percent more than employees with only a high school degree. Greater income leads to increased tax liability, with the government easily recouping its investment over the trained worker's lifetime.

Section 127 is the right tool for employees because it represents an unparalleled opportunity for workers. It empowers workers. It gives them a chance to broaden their expertise in many areas, beyond typical work-based training.

Madame Chair, Section 127 is the right tool for the entire business community. Businesses don't just give away money. We provide educational assistance because it helps us attract good

workers, keep them, and help them to become even more productive employees.

And that is why temporary extensions of Section 127 have been unsatisfactory. The temporary extensions bring about the tremendous administrative as long range plans for training are disrupted. While there is another Internal Revenue Code Section, Section 132, that allows for the narrow exclusion of strictly job-related assistance, businesses cannot comply with a standard that requires us to guess whether IRS will consider it job-related every time we send a worker for training. Limiting our employees to only job-related education also restricts employers in their efforts to cross-train employees and promote from within.

Although it hurts business, the loss of Section 127 is even worse for two groups-- current employees and laid off workers. Our employees have their educations disrupted in many instances, and their career aspirations are therefore put on hold.

While education is important for everyone, low income workers in particular rely on employer provided assistance to improve their career prospects. These employees, who may be hired initially to take care of routine administrative functions, take advantage of Section 127 to gain skills for higher paying jobs. Limiting these workers to job-related education only, is in essence relegating them to training for skills that cannot help them get ahead. The American Dream is all about advancing through hard work and education, not just maintaining the same status in the same job.

Laid off employees, in turn, are also affected by the loss of Section 127. In Connecticut we have had a lot of down-sizing. With Section 127, laid off workers often have the shock of the job loss somewhat lessened when their former companies pay for training for other jobs available in the community. Without Section 127, these laid off employees would be taxed on that training at the very time they have no income and desperately need help in securing another job.

With Section 127, on the other hand, our workers have a chance to broaden their educations, and prepare for the higher skilled jobs they **currently do not** have, but that are within reach through education.

We are in a fierce competition with other countries of the world, and our economic prosperity is at stake. We must use all of our available tools and resources to win.

I thank the Subcommittee for its time today, and I hope that you will continue to call on the Automobile Club of Hartford and the Society for Human Resource Management as you seek to restore and extend the exclusion for employee educational assistance.

Mr. HERGER. Thank you, Ms. Chase, for your testimony.
Ms. Easley.

STATEMENT OF PAMALA EASLEY, PAYROLL SUPERVISOR, VINNELL CORP., FAIRFAX, VIRGINIA; ON BEHALF OF AMERICAN PAYROLL ASSOCIATION

Ms. EASLEY. It is a pleasure for me to testify today on the important issue of the tax treatment of employer-provided educational assistance under section 127 of the IRC.

My name is Pamela Easley, and I am here on behalf of the APA, American Payroll Association.

The APA is a nonprofit, professional association representing over 11,000 companies and individuals on issues relating to wage and employment tax withholding, reporting, and depositing. Over 85 percent of the gross Federal revenues of the United States are collected, reported and/or deposited through company payroll withholding.

Under our system of voluntary compliance, payroll professionals, like me and my colleagues, are the Nation's tax collectors. For nearly 10 years, I have supervised the payroll operations for Vinnell Corp. in Fairfax, Virginia. Vinnell is a government contractor that, among other things, provides operations and maintenance assistance to U.S. military bases worldwide.

As part of its employee benefits package, Vinnell will reimburse its employees for up to $1,500 in tuition expenses per year which, as I will discuss later, I take full advantage of.

The APA strongly supports the withholding exclusion for education benefits under section 127. The on-again-off-again treatment of this important provision by Congress, however, has created an enormous amount of extra work for U.S. businesses. These problems are intensified when authorization expires midyear and is then reinstated retroactively, as was the case in 1993, and we fear may be the case this year.

In addition, this lack of permanency creates a hardship for working Americans and strains relationships between U.S. businesses and their employees.

First, I will discuss the administrative burdens that these repeated expirations have created. In 1993, when the provision was last reinstated, our company experienced a great deal of extra and costly paperwork. The worst problems came in making the adjustments for employees who had educational expenses in 1992. Because the authorization was reinstated retroactively, these employees had, in effect, overstated their income on their 1992 tax returns and were, thus, entitled to get money back for the Federal and State income taxes and for their share of FICA.

Vinnell was entitled to reimbursement for the employer's portion of FICA, but had to go through a great deal of time and costly paperwork to collect it.

In order to enable employees to get their refunds, we had to calculate the difference in the taxable wages for employees entitled to reimbursements, complete a W–3C, the cover sheet for corrected wage statements, and process and distribute corrected wage statements, W–2Cs.

We then had to ask the employees to sign a statement promising that they would not seek a FICA reimbursement from the government, and then we needed to manually cut checks to reimburse employees for FICA overpayments out of our own account.

Meanwhile, we had to tell the employees that in order to get a Federal tax refund, they would have to file an amended tax return. We made it as easy as we could for employees by providing them with copies of form 1040–X so they could amend their tax returns, but it was up to the individual employee to complete the form and send it in to the IRS.

To straighten out our own books and remain in compliance, we had to file amended quarterly tax returns, form 941–C and form 843, request for refund, seeking a refund for both the employer's and employee's portion of FICA.

It took me, along with my two assistants, a full week to sort out the problems. Figuring in labor and overhead, I estimate we spent about $3,000 on this project, and that is with only about 20 employees in our headquarters office taking classes.

I shudder to think about the time and money spent by my colleagues at Vinnell's parent company, BDM International, where I am told some 500 employees were affected.

The changes in the tax status of section 127 causes enormous confusion for employees who receive the benefit. Each time the provision expired, my staff, along with our human resources department, spent endless hours explaining and assuring our employees that the company was not voluntarily taking a promised benefit away.

The employees thought they were to receive a tax-free benefit for educational expenses for a certain amount and budgeted accordingly. In fact, the amount is reduced, and they don't understand why.

Although we forewarned the employees, the messages did not really get through until the workers saw the difference in their take-home pay.

I would like to stress that management at Vinnell realizes that they do not have to offer their educational benefit under increasingly difficult section 127. We could alternatively offer them under the more stable section 132 exclusions, but Vinnell has made the business decision to allow employees to advance their careers by enrolling in a broad range of courses, not just those they need for their current jobs.

Through this policy, we avoid the undesirable situation in which we would agree to reimburse one employee for a particular course that was necessary for the job, but we would have to say no to other employees who may want to take the same course in order to advance their careers.

At this point, I would like to talk a little bit about my own circumstances. In addition to being a payroll supervisor, I am also a student benefitting from Vinnell's educational assistance program.

I have been enrolled at the Woodbridge campus of the Northern Virginia Community College for 2 years. So far, I have taken four courses, and I have a grade point average of 4.0.

I am here to testify that the $1,500 that I had been receiving from Vinnell is vitally important to me. Three years ago, my hus-

band had his second open heart surgery after suffering a massive heart attack. He is now totally disabled. As a result, I am the sole wage earner for my family. I also have a 14-year-old daughter and a 16-year-old son. They, too, would one day like to go to college, and I would like to be a role model and provide financial assistance for them.

There is one last point that I would like to make. In conversations with my colleagues, a clear profile of the kind of employees who benefit the most from section 127 has emerged. Like myself, they tend to be women. Many are single parents. All are struggling financially. The educational assistance they get from their employers may be one of the few financial breaks they ever get in their lives.

I urge you to give full commitment to this important provision and make it permanent as proposed in H.R. 127, the Employee Educational Assistance Act of 1995. If that proves impossible, however, I hope you will stop hitting U.S. businesses with unnecessary and costly paperwork. This can be accomplished if you set the expiration date at the end of the year and not allow the provision to lapse. If you opt once again making the withholding exclusion retroactive, I urge you for the reasons outlined to work quickly and reinstate it this calendar year.

Thank you again for this opportunity to present my views as a paraprofessional and as a student. I would be pleased to answer any questions from you or your staff.

[The prepared statement follows:]

Testimony of the
American Payroll Association

Presented by Pamala Easley, CPP
Payroll Supervisor, Vinnell Corporation

It's a pleasure for me to testify today on the important issue of the tax treatment of employer-provided educational assistance under Sec. 127 of the Internal Revenue Code.

My name is Pamala Easley and I am here on behalf of the American Payroll Association (APA). The APA is a non-profit professional association representing over 11,000 companies and individuals on issues relating to wage and employment tax withholding, reporting and depositing. Over 85 percent of the gross federal revenues of the United States are collected, reported and/or deposited through company payroll withholding. Under our system of voluntary compliance, Payroll Professionals are the nation's tax collectors.

For nearly 10 years, I have supervised the payroll operations for the Vinnell Corporation in Fairfax, Virginia. Vinnell is a government contractor that, among other things, provides operations and maintenance assistance to U.S. military bases world-wide. As part of its employee benefits package, Vinnell will reimburse its employees for up to $1,500 in tuition expenses per year.

The APA strongly supports the withholding exclusion for education benefits under Sec. 127. The on-again, off-again treatment of this important provision by Congress, however, has created an enormous amount of extra work for U.S. businesses. These problems are intensified when the authorization expires mid-year and is then reinstated, retroactively, as was the case in 1993 (and, we fear, may be the case this year.) In addition, this lack of permanency creates hardship for working Americans and strains relationships between U.S. businesses and their employees.

First I will discuss the administrative burdens that these repeated expirations have created.

In 1993, when the provision was last reinstated, our company experienced a great deal of extra and costly paperwork. The worst problems came in making the adjustments for employees who had educational expenses in 1992. Because the authorization was reinstated retroactively, these employees had, in effect, overstated their income on their 1992 tax returns, and were thus entitled to get money back for their federal and state income taxes and for their share of FICA. Vinnell was entitled to reimbursement for the employer's portion of FICA, but had to go through a great deal of time and costly paperwork to collect it.

In order to enable employees to get their refunds, we had to:

- Calculate the difference in taxable wages for employees entitled to reimbursements;
- Complete a W-3c, the cover sheet for corrected wage statements; and
- Process and distribute corrected wage statements (W-2c's).

We then had to ask employees to sign a statement promising that they would not seek a FICA reimbursement from the government. And then we needed to manually cut checks to reimburse employees for FICA overpayments out of our own account.

Meanwhile, we had to tell employees that in order to get a federal tax refund, they would have to file an amended tax return. We made it as easy as we could for employees by providing them with copies of the Form 1040X so they could amend their tax returns. But it was up to the individual employee to complete the form and send it in to the IRS.

To straighten out our own books and remain in compliance, we had to file amended quarterly tax returns (Forms 941c) and a Form 843 (Request for Refund), seeking a refund for both the employer's and employees' portion of FICA.

Processing the reimbursements for employees who took classes in 1993 was a bit easier because the changes applied to the current calendar year. However, we still had to reimburse employees for the money that we had withheld and reduced their taxable income up until the point that the provision was reinstated. Again, those checks had to be cut manually. And then we, as a company, had to adjust our federal tax liability.

It took me, along with my two assistants, a full week to sort out the problems. Figuring in labor and overhead, I estimate we spent about $3,000 on this project -- and that's with only about 20 employees in our headquarters office taking classes. I shudder to think about the time and money spent by my colleagues at Vinnell's parent company, BDM, International, where I'm told some 500 employees were affected.

The change in the tax status of Sec. 127 causes enormous confusion for employees who receive the benefit. Each time the provision expired, my staff, along with our Human Resources Department, spent endless hours explaining and assuring our employees that the company was not voluntarily taking a promised benefit away from them. Employees thought they were to receive a tax free benefit for educational expenses for a certain amount and budgeted accordingly. In fact, the amount is reduced and they don't understand why. Although we forewarned employees, the message didn't really get through until workers saw the difference in their take home pay.

Our workers' confusion and frustration is compounded if they talk to friends and family members at other companies where withholding isn't taken out. And that brings up another problem: Many companies have begun to avoid this hardship for employees by gambling on the deduction being reinstated. As a result, they don't withhold.

When the provision expired in 1992, the APA took a straw poll among mostly large employers. Twenty-one of the 29 respondents to our informal survey -- more than 72 percent -- gambled on Congress enacting a retroactive extender, as it had done five times previously. As a result, they did not follow the letter of the law and neither reported nor withheld, as they were required to do.

On the other hand, compliant companies like Vinnell were, in effect, punished for their compliance. We had to spend the time and money revisiting our records and going through the procedures I have already outlined.

To date, I have gotten assurances from management that Vinnell is committed to its educational assistance benefit and has no plans to terminate it, despite the burden it has caused. It maintains this commitment even though the benefit:

- now costs as much as $167 more per employee. (The extra cost is incurred when an employer absorbs its share of FICA, as well as federal and state unemployment on the tuition reimbursement);

- causes extraordinary administrative burden and costly paperwork for businesses that must correct their wage records each time there is a retroactive change; and

- causes employee relations problems and low morale.

It seems to me, some other companies would think about discontinuing this voluntary, pro-employee benefit under these harsh circumstances.

I'd like to stress that management at Vinnell realizes they do not have to offer their educational benefit under the increasingly problematic Sec. 127 exclusion. We could, alternatively offer them under the more stable Sec. 132 exclusion. But Vinnell made the business decision to allow employees to advance their careers by enrolling in a broad a range of courses -- not just those they need for their current jobs. Through this policy, we avoid the undesirable situation in which we would agree to reimburse one employee for a particular course that was necessary for the job, but would have to say "No" to other employees who may want to take the same course in order to advance their careers.

In addition to being a Payroll Supervisor, I am also a student benefitting from Vinnell's educational assistance program. So I know, from my own personal experience, just how important the withholding exemption is and just how hard working Americans are hit by the non-permanent status of this provision.

I have been enrolled at the Woodbridge campus of the Northern Virginia Community College for two years. I am working towards three Associate degrees: in computer science, accounting and business administration. So far, I have taken four courses and have a 4.0 grade point average.

Although I still have a long way to go to complete my course requirements, I fully intend to apply my credits from NOVA towards a bachelor's degree at a four-year school. My career goal is to develop payroll software packages for companies like Vinnell.

I am here to testify that the fifteen hundred dollars that I had been receiving from Vinnell is vitally important to me. Three years ago, my husband had his second open heart surgery after suffering a massive heart attack. He is now totally disabled. As a result, I am the sole wage earner for my family. I also have a 14-year old daughter and a 16-year old son. They, too, would one day like to go to college. I would like to be a role model for them and provide financial assistance for them.

But with the future of Sec. 127 so cloudy, I wonder if I will be able to afford to continue my own education, let alone help out my children. Before Sec. 127 expired, I was reimbursed for the full cost of my courses, up to $1,500. Now, however, once the various taxes are taken out, I will receive only about two-thirds of that. As long as Sec. 127 is defunct, I must come up with the difference on my own. And once I transfer to a four year college, my costs will increase by as much as 380 percent.

There is one last point I would like to make. Through conversations with my colleagues, a clear profile of the kind of employees who benefits the most from Sec. 127 has emerged. Like myself, they tend to be women. Many are single parents. All are struggling financially. The educational assistance they get from their employers may be one of the few financial breaks they ever get in their lives. I urge you to give a full commitment to this important provision and make it permanent as proposed in H.R. 127, the Employee Educational Assistance Act of 1995. If that proves impossible, however, I hope you will stop hitting U.S. businesses with unnecessary and costly paperwork. This can be accomplished if you set the expiration date at the end of the calendar year and not allow the provision to lapse. If you opt to once again make the withholding exclusion retroactive, I urge you, for the reasons outlined already, to work quickly and reinstate it this calendar year.

Thank you again for this opportunity to present my views as a Payroll Professional and as a student. I would be pleased to answer any questions from you or your staff.

Mr. HERGER. Thank you, Ms. Easley.

Mr. Williamson, if you would testify, please, and if we could try to keep our testimonies to approximately 5 minutes if we could, please.

STATEMENT OF ROBERT D. WILLIAMSON, PRESIDENT, AMERICAN SOCIETY FOR PAYROLL MANAGEMENT, NEW YORK, NEW YORK

Mr. WILLIAMSON. Thank you, Mr. Chairman. This will be very succinct.

Thank you for the opportunity to appear before the Subcommittee today. We appreciate the Subcommittee's interest in hearing from the payroll community because our members, the managers responsible for payroll and employment taxes of large firms, are the people who have had to handle the administrative consequences of the on-again-off-again status of the tax break for nonjob related educational assistance.

Section 127 has caused problems in payroll for more than a decade. It has expired six times and has been restored retroactively five times.

By 1992, many employers ignored the expiration of the tax break in anticipation of the usual restoration. We did a survey at that time, and it showed it was about 50/50.

Compliant employers had tax reimbursements they made during the last 6 months of 1992 and included the amounts on their W–2 forms and employment tax returns. They were sorry they did because the following year OBRA 1993 restored the tax break retroactively. This changed formerly compliant employers to noncompliant, and the formerly noncompliant to compliant.

To make the administrative consequences worse, ASPM's, American Society for Payroll Management, recommendation that corrections to tax returns and information statements for 1992 that could be reported on 1993 forms was turned down. The result? The formerly compliant, now noncompliant employers issued W–2Cs, W–3Cs, 941–Cs, and State forms, and affected employees presumably corrected their individual 1040 tax returns. Thus, the formerly noncompliant made compliant by OBRA 1993 did nothing and we are off the hook.

Today, May 9, the payroll people are in the same quandary. Should they act on the expiration of the tax break or should they blink and wait for another retroactive reinstatement?

Here is what Clark G. Case, payroll manager of the city of Winston-Salem, North Carolina, has to say:

> We are paying educational assistance as fully taxable income to Federal income tax, FICA, and State taxes. The last time section 127 expired, we continued to pay it as nontaxable, counting on Congress to retroactively activate it. This time,

this means this year,

> I decided that the odds of its extension were not as good as before. We have complied with the taxability. I talked to the guys who do payroll in another State, and they have made the opposite decision and are not taxing the payments because they got burned when they complied the last time. If Congress extends it, it had better be permanent or they will never get me to comply again. It is a real pain to reinstate W–2s and everything else you have to do if it goes past the end of the year. I have already budgeted to increase the benefit by enough to offset the taxability effect on the employees for the coming fiscal year. This almost doubles the cost of

the benefit, but the people who use it are almost uniformly our employees who make less than $24,500 a year, and the taxability effect puts too much of a burden on them to go back for college credit.

Sensible tax policy and good business practice require that section 127 should be permanently settled one way or the other. If it is to be reinstated, the effective date should be January 1, 1995, with relief for compliant employers that would allow them to correct the amounts of tax withheld by adjusting other amounts later in 1995. If the tax break is not reinstated, similar relief should be given to noncompliant employers, the people who incorrectly guessed the 1995 roll of the dice to permit corrections later in 1995 without penalty or interest assessments.

Thank you, Mr. Chairman.

[The prepared statement follows:]

AMERICAN SOCIETY FOR PAYROLL MANAGEMENT

Testimony of Robert D. Williamson, President
before the
Subcommittee on Oversight
May 9, 1995
on
Sec. 127 Employer-Provided Non-Job-Related Educational Assistance

Madame Chairwoman:

Thank you for the opportunity to appear before the Subcommittee today. We appreciate the Subcommittee's interest in hearing from the payroll community because our members, the managers responsible for payroll and employment taxes at large firms, are the people who have had to handle the administrative consequences of the "on-again, off-again" status of the tax break for non-job-related educational assistance. Section 127 has caused problems over more than a decade: it has expired 6 times and has been restored retroactively 5 times:

History of Section 127 Provisions
(source: 1993 Green Book)

1978	Enacted (through 1983)
1983	Expired Dec. 31, 1983
1984	Retroactively extended through 1985 (adopted $5,000 limit)
1985	Expired Dec. 31, 1985
1986	Extended retroactively through 1987 (increased limit to $5,250)
1987	Expired Dec. 31, 1987
1988	Extended retroactively through 1989 (made inapplicable to graduate level courses)
1989	Extended through Sept. 30, 1990
1990	Expired Sept. 30, 1990; retroactively extended through 1991 (repealed graduate level restriction)
1991	Extended through June 30, 1992
1992	Expired July 1, 1992
1993	Extended retroactively through Dec. 31, 1994

By 1992, many employers ignored the expiration of the tax break in anticipation of the usual restoration. (A survey conducted among ASPM members showed that the split between compliant and non-compliant was 50-50.) Compliant employers taxed the reimbursements they made during the last 6 months of 1992 and included the amounts on their W-2 forms and employment tax returns. They were sorry they did because in the following year OBRA 1993 restored the tax break retroactively. This changed formerly compliant employers to non-compliant and the formerly non-compliant to compliant. To make the administrative consequences worse, ASPM's recommendation that corrections to tax returns and information statements for tax year 1992 be reported on 1993 forms was turned down. The result? The formerly compliant (now non-compliant) employers issued W-2c's, W-3c's, and 941c's and related state forms, and affected employees presumably corrected their individual 1040 tax returns. The formerly non-compliant made compliant by OBRA 1993 were "off the hook".

Today, May 9, payroll people are in the same quandary: should they act on the expiration of the tax break, or should they "blink" and wait for another retroactive reinstatement? Here's what Clark G. Case, payroll manager for the City of Winston-Salem, North Carolina, has to say:

"We are paying educational assistance as fully taxable income subject to federal income tax, FICA and state taxes. The last time Section 127 expired, we continued to pay it as nontaxable counting on Congress to retroactively activate it. This time I decided that the odds of its extension were not as good as before, so we have complied with its taxability. I talked to the guys who do payroll at another state and they have made the opposite decision and are not taxing the payments because they got burned by complying last time. If Congress extends it, it had better be permanent or they will never get me to comply again. It is a real pain to restate W-2's and everything else you have to do if it goes past an end of a year. I have already budgeted to increase the benefit by enough to offset the taxability effect on the employees for the coming fiscal year. This almost doubles the cost of the benefit, but the people who use it are almost uniformly our employees who make less than $24,500 per year and the taxability effect puts too much of a burden on them to go back for college credit."

Sensible tax policy and good business practice require that Section 127 should be permanently settled one way or the other. If it is to be reinstated, the effective date should be January 1, 1995 with relief for compliant employers (who taxed 1995 reimbursements) that would allow them to correct the amounts of tax withheld by adjusting other amounts withheld later in 1995. If the tax break is not reinstated, similar relief should be given non-compliant employers, the people who incorrectly guessed the 1995 roll of the dice, to permit corrections later in 1995 without penalty or interest assessments.

Mr. HERGER. Thank you, Mr. Williamson.
Mr. Thornton, if you would testify, please.

STATEMENT OF STAFFORD E. THORNTON, PRESIDENT, AMERICAN SOCIETY OF CIVIL ENGINEERS; ON BEHALF OF AMERICAN ASSOCIATION OF ENGINEERING SOCIETIES

Mr. THORNTON. Good afternoon. My name is Stafford Thornton. I am a registered professional engineer and the president of the American Society of Civil Engineers. I also serve as the director of the Technical Assistance Center at the West Virginia Institute of Technology.

My statement today is being endorsed by the AAES, American Association of Engineering Societies, which represents 800,000 engineers in this country.

I am pleased to be here today to speak in support of permanent extension of 127. ASCE, American Society of Civil Engineers, respectfully recommends a permanent extention of section 127 retroactive to December 31, 1994.

The ASCE as the country's oldest national engineering society, has 115,000 members working in private practice, government, research, and academia. The Society's major goals are to develop engineers who will improve technology and apply it to further the objectives of society as a whole, to promote the dedication and technical capability of its members, and to advance the profession of civil engineering.

ASCE is a strong supporter of the bill introduced by Congressman Levin, the Employee Educational Assistance Act of 1995, which could make section 127 permanent. This bill currently has 87 cosponsors. The legislation has always enjoyed strong bipartisan support on both sides of Capitol Hill.

The American Society of Civil Engineers believes reasonable educational assistance paid for by an employer should not be considered as additional employee income. ASCE supports this exclusion for undergraduate, graduate, and continuing education courses. Currently, section 127 allows employers up to $5,250 per year for each of their employees in tax-free educational benefits.

Over the years, section 127 has been allowed to expire only to subsequently be reinstated, sometimes retroactively. On at least one other occasion, the exclusion for 127 for graduate studies was curtailed, which had a particularly harmful impact on our members.

This unpredictable handling of section 127 has caused confusion among employers and employees, and has tended to discourage rather than promote employer paid educational assistance.

The economic vitality and global competitiveness of the United States are critically dependent upon a highly trained technical work force. Graduate and continuing education for the American civil engineering work force is not a luxury, but rather an essential element of professional practice.

Keeping pace with new and expanding fields of technology demands ongoing education if America is to successfully meet the new reality of intense global competition.

Our members are committed to lifelong learning. There are seven fundamental canon areas. The Code of Ethics states that engineers

shall continue their professional development throughout their careers and shall provide opportunities for the professional development of those engineers under their supervision.

Another facet of this issue is the need to produce quality, educated engineers who can compete with foreign engineers, since it is the policy of most foreign governments and employers to send their students to U.S. universities where foreign students now constitute more than half of the graduate student bodies in many technical fields.

According to the data we have seen, section 127 benefits do not accrue disproportionately to higher paid employees. Nearly 99 percent earn less than $50,000, 71 percent less than $30,000, and 35 percent less than $20,000.

Civil engineers, despite meeting rigorous educational standards, are not among the most highly compensated professionals when compared to other professions. ASCE research reports the average starting salary for civil engineers be $32,000. Having to pay tax up to $5,250 a year, which is the cap under section 127, would certainly be a great burden on many of these people, particularly the ones with families.

With respect to revenue considerations, the modest impact of section 127 on the Treasury, ASCE strongly believes that the benefits to society far outweigh the cost.

On behalf of ASCE and AAES, thank you for allowing me to appear before the Committee today, and I will be happy to respond to any questions.

Thank you.

[The prepared statement follows:]

STATEMENT OF STAFFORD E. THORNTON, P.E.
PRESIDENT, AMERICAN SOCIETY OF CIVIL ENGINEERS

Good afternoon Madam Chair and members of the subcommittee. My name is Stafford E. Thornton. I am a Registered Professional Engineer and the President of the American Society of Civil Engineers (ASCE). I also serve as Director of the Technical Assistance Center at the West Virginia Institute of Technology. My statement today is being endorsed by the American Association of Engineering Societies (AAES), which represents 800,000 engineers nation-wide.

OVERVIEW

I am pleased to be at this important hearing today on extending certain tax code provisions to urge support for Section 127 of the Internal Revenue Code (IRC), which allows individuals to receive tax free employer paid educational assistance. ASCE, which has a long-standing position in support of Section 127, respectfully recommends permanent extension of Section 127 retroactive to December 31, 1994.

AMERICAN SOCIETY OF CIVIL ENGINEERS

The American Society of Civil Engineers, founded in 1852, is the oldest national engineering society in the United States. Membership, held by 115,000 individual professional engineers, is about equally divided among engineers in private practice; engineers working for federal, state or local governments; and those employed in research and academia. The Society's major goals are to develop engineers who will improve technology and apply it to further the objectives of society as a whole, to promote the dedication and technical capability of its members and to advance the profession of civil engineering.

AMERICAN ASSOCIATION OF ENGINEERING SOCIETIES

The American Association of Engineering Societies (AAES) is a multi-disciplinary organization dedicated to advancing the knowledge, the understanding and the practice of engineering in the public interest. Located in Washington, DC, AAES includes 28 engineering and scientific societies with over 800,000 members in industry, government and education.

THE EMPLOYEE EDUCATIONAL ASSISTANCE ACT OF 1995

ASCE is a strong supporter of the bill introduced by Congressman Levin, H.R. 127, the Employee Educational Assistance Act of 1995 which would make Section 127 permanent. This bill currently has 87 co-sponsors. This legislation has always enjoyed strong bi-partisan support on both sides of Capitol Hill.

ASCE believes reasonable educational assistance paid for by an employer should not be considered as additional employee income. ASCE supports exclusion of employer-paid educational assistance for undergraduate, graduate and continuing education courses from the employee's gross income for tax purposes. Currently, Section 127 allows employers to provide up to $5,250 per year to each of their employees in tax-free reimbursement for tuition, books and fees for non-job or job related education. Key benefits of Section 127, which was first enacted in 1978, are the reduced administrative inequities and tax code complexities associated with not having to determine whether certain educational or training courses are job-related. For example, a civil engineer with technical expertise in bridge design but in need of business or management training could use Section 127.

Over the years Section 127 has been allowed to expire, only to be subsequently reinstated (sometimes retroactively). On at least one other occasion the exclusion under Section 127 for graduate study costs was curtailed, which had a particularly harmful impact on our members. This unpredictable handling of Section 127 by the Federal Government has caused confusion among employers and employees, and has tended to discourage rather than promote employer-paid educational assistance.

The economic vitality and global competitiveness of the United States are critically dependent upon a highly trained technical work force. Graduate and continuing education for the American civil engineering work force is not a luxury, but rather an essential element of professional practice. Keeping pace with new and expanding fields of technology demands on-going education if America is to successfully meet the new reality of intense global competition. Our members are committed to life-long learning. The Seventh Fundamental Canon of ASCE's Code of Ethics states: "Engineers shall continue their professional development throughout their careers, and shall provide opportunities for the professional development of those engineers under their supervision".

Another facet of this issue is the need to produce quality educated engineers who can compete with foreign engineers since it is the policy of foreign governments and employers to send their students to U.S. universities where foreign students now constitute more than half of the graduate student body in many technical fields.

Extension of Section 127 is also important because:

- For many Americans, employee educational assistance benefits are the only way they can obtain a college or graduate-level education.

- The program is a proven one. According to the American Society for Training & Development (ASTD), since 1978 more

than seven million Americans have been able to work and attend classes in order to improve their skills and qualify for better jobs.

- This program is of special importance to women and minorities, as well as to workers who are at the bottom of the career ladder and who need better skills in order to move up.

- Section 127 benefits are used by employers to retrain workers either for other work within the company or, in the case of layoffs, for other employment in the community.

Contrary to the perception of some people, Section 127 does not confer disproportionate benefits on higher-paid workers. According to an analysis of the Department of Education's National Post-Secondary Student Aid Survey by Coopers & Lybrand in 1989, Section 127 benefits appear to be distributed in a manner closely paralleling earnings among the labor force as a whole. Benefits did not accrue disproportionately to higher-paid employees. Nearly 99% earned less than $50,000, 71% less than $30,000 and 35% less than $20,000.

Civil engineers, despite meeting rigorous educational standards, are not among the most highly compensated professionals when compared to other professions. ASCE research reports that the average starting salary for civil engineers was $32,000 in 1993. Mid-career civil engineers with Master's degrees or engineering licenses received salaries averaging $50,000 - $58,000 in 1993. Some may ask: "What kinds of courses are Section 127 recipients likely to take?" Again, referencing the Coopers & Lybrand study, nearly half of those with identified majors who were using Section 127 benefits were taking business-related courses. The remainder were taking, in descending order, courses in engineering, health science/nursing, education and computer science.

Another important consideration for Congress is the revenue loss associated with the tax exclusion for employer paid educational assistance. The most recent Joint Committee on Taxation (JCT) cost figure was the $545 million estimate for an 18 month extension that was generated in 1993. We expect that a new JCT cost estimate will be forthcoming. The JCT cost estimates for Section 127 have varied considerably over the years. Whatever the relatively modest cost to the U.S. Treasury associated with Section 127, ASCE strongly believes that the benefits to society far outweigh the cost.

Madam Chair, on behalf of ASCE and the AAES, thank you for allowing me to appear before the committee today. I would be happy to respond to any questions.

Mr. HERGER. Thank you very much, Mr. Thornton.
Mr. McVey, please.

STATEMENT OF ROSS J. MCVEY, ASSISTANT CONTROLLER AND DIRECTOR, TAX OF TELEPHONE & DATA SYSTEMS, INC., MIDDLETON, WISCONSIN

Mr. MCVEY. Good afternoon. My name is Ross McVey. I am the assistant controller and director of Tax of Telephone and Data Systems, or TDS. We welcome and appreciate the opportunity to provide testimony in support of the permanent addition of the exclusion for employer-provided educational assistance.

TDS is a diversified telecommunications company providing telephone, cellular telephone, and radio paging services in 37 States throughout the United States. TDS provides these services through its three subsidiaries, TDS Telecom, United States Cellular Corp., and American Paging. These subsidiaries have operations in approximately 225 business locations. While the TDS family employs over 5,000 people, a majority of these individuals are working at a typical small business located in rural America.

TDS's continued expansion into new markets, combined with the technological advances in the telecommunications industry and with increased competition, place greater demands on our company and our employees. The continued success of TDS depends, in large measure, on a well-educated and well-trained work force.

A hallmark of TDS has been its investment in the continuing education and training of its employees. To this end, TDS maintains an employer-provided educational assistance plan.

During 1994, TDS spent over $500,000 in educational assistance. The exclusion from income and payroll taxes of employer-provided educational assistance payments benefits the employee, the employer, as well as the Nation.

A well-educated and well-trained work force is vital to the Nation. We must strive to be a leader, a leading competitor in the global economy. The need for highly skilled employees will continue to increase in the information age. As more of the Nation's citizens move into professional and technical careers, our standard of living will increase.

For these reasons, education should be a top priority of the government. We believe that the investment the government makes now will be recouped many times over in the life of an individual.

The educational assistance program has been a valuable asset to TDS. The educational assistance program at TDS helps to increase employee loyalty, morale, and productivity. We believe that a well-educated and well-trained employee is more flexible and can adapt quicker to a changing business environment. This is important to TDS as we reorganize and modify our operations to meet customer demands.

In addition, the technological changes in the telecommunications industry will require our employees to pursue educational and training opportunities not only within their chosen field, but also in other areas that affect TDS.

The employee benefits in several ways from an employer-provided educational assistance program. Often, this is the only fi-

nancial assistance available. A full-time employee generally is not eligible for traditional forms of student aid.

In addition, the opportunities for advancement are much greater when an employee completes their bachelor's degree or obtains an advanced degree. The educational assistance will allow an employee to complete their education much sooner than if the employee were to finance the full cost of their own education. Currently in my department, 35 percent of the employees have either been accepted into a graduate program or are working on an advanced degree.

The repeal of the exclusion from income of employer-provided educational assistance payments would significantly hamper continued improvements to the American work force by adding considerable cost to both the employee and the employer in terms of income and payroll taxes.

The exclusion from income of employer-provided educational assistance under section 127 of the IRC was first enacted in 1978. The provision was originally set to expire in December of 1983. Subsequent to that, the provision has been extended at least six times.

While recognizing the budgetary constraints that are pervasive throughout tax legislative changes, the temporary status of this provision only helps to reduce the efficiency of congressional activity.

To summarize, TDS strongly advocates the permanent adoption of the exclusion from income of employer-provided educational assistance. An educational assistance program benefits the employee, the employer, and the Nation.

We would like to stress that for many of our employees, an educational assistance program is the only means of obtaining a higher education in a reasonable amount of time.

I thank you very much for the opportunity to present TDS's views here today.

[The prepared statement follows:]

Testimony of Ross J. McVey

on Behalf of
Telephone and Data Systems, Inc.

Concerning Extension of IRC Section 127

Good morning, my name is Ross J. McVey and I am the Assistant Controller and Director - Tax of Telephone and Data Systems, Inc. or TDS. We welcome and appreciate the opportunity to provide testimony in support of the permanent addition of the exclusion for employer provided educational assistance to the Internal Revenue Code. TDS is a diversified telecommunications company, headquartered in Chicago, Illinois, providing telephone, cellular telephone, and radio paging services in 37 states throughout the U.S. and the District of Columbia. TDS provides these services through its three subsidiaries, *TDS Telecom, United States Cellular Corporation, and American Paging, Inc.* The subsidiaries have operations in approximately 225 business locations. So while the TDS family employs over 5,000 people, a majority of these individuals are working at a typical small business located in suburban and rural America.

TDS's continued expansion into new markets combined with the technological advances in the telecommunications industry and with increased competition place greater demands on our company and our employees. The continued success of TDS depends in large measure on a well educated and well-trained workforce. A hallmark of TDS has been its investment in the continuing education and training of its employees. To this end, TDS has maintained an employer-provided educational assistance plan for the past several years. Since 1993, TDS has spent over $500,000 in educational assistance. The exclusion from income and payroll taxes of employer-provided educational assistance payments benefits the employee, the employer, as well as the nation.

A well-educated and well-trained work force is vital to the nation. We must strive to be a leading competitor in the global economy. The need for highly skilled employees will continue to increase in the information age. As more of the nation's citizens move into professional and technical careers, our standard of living will increase. For these reasons, education should be a top priority of the government. We believe that the investment the government makes now will be recouped many times over in the life of an individual's career.

The educational assistance program has been a valuable asset to TDS. The educational assistance program at TDS helps to increase employee loyalty, morale, and productivity. We believe that a well-educated and well-trained employee is more flexible and can adapt quicker to a changing business environment. This is important to TDS as we reorganize and modify our operations to meet customer demands. In addition, the technological changes in the telecommunications industry will require our employees to pursue educational and training opportunities not only within their chosen field, but also in other areas that affect TDS.

The employee benefits in several ways from an employer-provided educational assistance program. Often, this is the only financial assistance available. A full-time employee generally is not eligible for traditional forms of student aid. In addition, the opportunities for advancement are much greater when an employee completes his bachelor's degree or obtains an advanced degree. The educational assistance will allow an employee to complete his education much sooner than if the employee were to finance the full cost of his education. Currently in my department, 35 percent of the employees have either been accepted into a graduate program or are working on an advanced degree.

The repeal of the exclusion from income of employer-provided educational assistance payments would significantly hamper continued improvements to the American work force by adding considerable costs to both the employee and the employer in terms of income and payroll taxes. Section 162 of the Internal Revenue Code, in its present form, allows an employee to deduct from income amounts incurred for education or training which maintain or improve skills in his present position or meet the express requirements of his employer. The educational expenses are not deductible if the education qualifies the employee for a new trade or business. Additionally, the employee may deduct the expenses only if he itemizes deductions and the educational expenses combined with other miscellaneous deductions exceed two percent of his Adjusted Gross Income (AGI). Expenses paid for by the employer may be excluded from income of the employee as a working condition fringe benefit under Section 132 if the education or training is work related as defined in Section 162. Much of the course work undertaken by employees at TDS would not qualify under Sections 132 and 162 because the education would qualify them for another trade or business.

The exclusion from income of employer-provided educational assistance under Section 127 of the Internal Revenue Code was first enacted in 1978. The provision was originally set to expire on December 31, 1983. Subsequent to that date, the provision has been extended seven times. The latest extension expired on December 31, 1994. The temporary nature of this provision adds needless complexity and time to both Congressional and business activities. Each of these expirations required Congressional review and analysis. While recognizing the budgetary constraints that are pervasive throughout tax legislation changes, the temporary status of this provision only helps to reduce the efficiency of Congressional activity.

The continuing expiration and extension of this provision have a negative impact on business as well. This additional burden is best illustrated by the most recent extension of the provision after it expired on June 30, 1992. The exclusion of employer-provided educational assistance was then retroactively reinstated for taxable years beginning after June 30, 1992 as part of the Omnibus Reconciliation Act of 1993. Therefore, companies that had followed the existing tax law and treated such assistance as taxable income for amounts paid in the last half of 1992, were required to handle the administrative burden created by the reinstatement of this exclusion in the following year. The typical small business did not and does not have the staff or specialized knowledge to properly address this change. The result is that additional costs were incurred by businesses to ensure compliance with the tax law. To eliminate the additional time and complexity surrounding this provision, we strongly advocate the permanent addition of this exclusion to the existing tax law.

In conjunction with making this provision permanent, we urge Congress to index the cap on the exclusion. The limit on excludable benefits is currently $5,250. The cap was last increased as part of the Tax Reform Act of 1986. Tuition expenses for education have risen faster than the rate of inflation for the past several years. Between 1980 and 1993, the Consumer Price Index increased 75 percent. During the same period, tuition at public universities increased 207 percent and tuition at private institutions increased 220 percent. In order for the exclusion to remain effective, the cap should be indexed at least for the rate of inflation.

To summarize, TDS strongly advocates the permanent adoption of the exclusion from income of employer provided educational assistance. An educational assistance program benefits the employee, employer and the nation. Again, we would like to stress that for many of our employees, an educational assistance program is the only means of attaining a higher education in a reasonable amount of time. The benefits to TDS and our economy are a more competitive and adaptable work force. By making this provision permanent, both Congress and business save time and reduce costs. Indexing the cap on educational assistance will keep the exclusion meaningful if education costs continue to rise.

Mr. HERGER. Thank you very much, Mr. McVey.

Ms. Chase, you mentioned that you are, if I understood correctly, a product of this program and that it had helped you and enabled you to go on for further education and better yourself in your employment.

I guess my question would be, within your company, if section 127 were to be allowed to expire, how would you anticipate that that might influence your company as far as continuing to provide tuition assistance for other employees as you were able to?

Ms. CHASE. I am afraid that it becomes another more administrative burden. In human resources, we are trying to balance such things as COBRA and such things as Family Medical Leave Act. We have State law to follow. We have Federal law to follow. I don't think that it would go away, but I think that we would have to gear up to just handle the administrative burden that would be associated with that if it was handled differently.

Does that answer your question?

Mr. HERGER. More or less.

Do you feel your company would continue? Do you think there might be a possibility that your company or others might, perhaps, be cut because of that?

Ms. CHASE. I believe we would continue, but it would be another point I would have to sell to my CEO. Yes, but I do believe it would continue.

Mr. HERGER. OK. During good times, if your company is doing well, obviously that would be something you would do. Perhaps, if times were a little bit tougher, that might be an area that could be done away with.

Ms. CHASE. It could be cut.

Mr. HERGER. Mr. McVey, I understand you have a company in the Happy Valley of California.

Mr. MCVEY. Happy Valley, California. Yes, sir. I certainly do.

Mr. HERGER. It is good to have you with us.

Mr. MCVEY. We have 23 employees in the State of California, and 2 of them are currently engaged in the continuing education program. Two of your constituents would be directly affected by this program.

Mr. HERGER. I appreciate you letting me know that.

If section 127 were allowed to expire, a deduction for some job related education expense would be permitted, subject to the floor on miscellaneous itemized deductions under section 162. What would be the administrative burden associated with determining whether education expenses are job related?

Mr. MCVEY. At the present time, we are trying to go through that in order to comply with the law as it currently reads, and it is a particularly burdensome task to have to go through and figure out whether 5,000 employees are or are not in school and get them to send us a copy of their class list and try to decide whether that particular course is job related based on their job description.

Admittedly, there are some times when you simply guess. The reinstitution of section 127 would relieve us of that particular burden. It will eliminate future controversies with the Internal Revenue Service when they come back to do an audit, and that can only benefit both sides.

Mr. HERGER. Thank you very much.

Mr. Levin will inquire.

Mr. LEVIN. Thank you.

I think, Mr. Herger, your question on sections 162 and 127 is, indeed, a cogent one, and I think the answer is very helpful.

Let me just say I think all of your testimony was very helpful, and you added some increased evidence of the bureaucratic mess that is created by on-again-and-off-again, and it would be much preferable if we could decide on a public policy and make it permanent, and I hope all of us will keep that in mind.

With both your personal stories, and across-the-board professional experiences, your testimonies have been illuminating.

Thank you very much.

Mr. HERGER. I thank this panel. With no further questions, we thank you for joining us.

If the next panel would step forward, please. Wayne Ashworth, president of Virginia Farm Bureau, Richmond, Virginia, on behalf of the American Farm Bureau; John Young, president of the National Council of Agricultural Employers; Abbey Meyers, president, National Organization for Rare Disorders; Lisa Raines, vice president, government relations, Genzyme Corp.; James A. Joseph, president and chief executive officer, Council on Foundations; Jesse J. Thompson, founder, Provident Benevolent Foundation; and Joseph A. Licata, vice president of employee benefits, Salomon Brothers.

Mr. Ashworth, if you would present your testimony, please.

STATEMENT OF C. WAYNE ASHWORTH, PRESIDENT, VIRGINIA FARM BUREAU, RICHMOND, VIRGINIA; ON BEHALF OF THE AMERICAN FARM BUREAU FEDERATION

Mr. ASHWORTH. Yes, sir. Mr. Chairman and Members of the Oversight Subcommittee, I want to thank you for the opportunity to appear before you today representing the American Farm Bureau Federation.

I am Wayne Ashworth, president of the Virginia Farm Bureau. The Virginia Farm Bureau represents more than 114,000 member families. I have been involved in the Farm Bureau in one capacity or another since 1963. The American Farm Bureau is the Nation's largest general farm organization. The Farm Bureau has members in all 50 States and Puerto Rico, representing some 4.4 million member families nationwide. Farm bureau and ranch members are engaged in the production of virtually every agricultural commodity grown commercially in the United States.

I am here to present the views of the AFBF, American Farm Bureau Federation on the Federal Unemployment Tax Act (FUTA), and unemployment insurance (UI), coverage of temporary aliens agricultural workers admitted to the United States under the H2–A Program

When the UI Program was created, agricultural employers were exempt. In 1976 the Federal law was changed to extend eligibility to employees of certain agricultural employers. When UI coverage was extended to agricultural workers, payroll taxes were likewise extended to the employers. Temporary alien workers were exempted from FUTA taxes.

Workers under the H2–A Program are admitted to the United States to work for limited periods of time and are employed across the United States. They work in tobacco, apples and vegetables in my home State of Virginia and in the States of Kentucky and Tennessee. They work in tobacco and vegetables in North Carolina. They work in fruit, vegetables and nursery crops in New England and New York. They are employed in sheep herding in 12 western States, including North Dakota, South Dakota, Wyoming, Montana and California.

The policy resolutions adopted by the elected voting delegates of the member State Farm Bureaus at the 76th annual meeting of the AFBF, in January 1995 specifically addressed the issue of FUTA coverage for H2–A workers and opposed the imposition of Federal unemployment insurance payroll taxes on H2–A employers. The Farm Bureau policy is clear in its opposition to extending UI to H2–A workers and request that the H2–A FUTA exemption be extended permanently.

There are several reasons why UI should not be extended to H2–A workers. H2–A workers must return to their home countries at the conclusion of their employment and cannot remain unless they have secured additional employment with an H2–A certified employer. Due to their immigration status as temporary alien agricultural workers, H2–A workers are unable to meet the statutory unemployment eligibility test of being willing, able and available to work.

To force employers of H2–A workers to pay into the UI system would only serve to undermine the insurance feature of the program. In effect, employers would be forced to pay for insurance protection for their employees against financial loss associated with unemployment, despite the fact that no such injury can occur.

In addition, there is little in the way of additional revenue to the Federal Unemployment Trust Fund to be realized, if FUTA taxation is extended to the wages of H2–A workers. Employers are required to pay a FUTA tax of 0.8 percent on the first $7,000 an employee earns. This is taxable wage base. If 15,000 H2–A workers in any given year—in 1993, the U.S. Department of Labor certified 17,000 H2–A slots—earned as much as a taxable wage of $7,000, the employers' tax liability to the Federal Government under FUTA would be approximately $56 per worker. Therefore the total collected from the H2–A FUTA tax at the Federal level would be $840,000.

Extension of the FUTA to H2–A workers do not result in a tax windfall for the Federal Government, but does entail additional compliance requirements for farmers and ranchers. Employers would be responsible for significantly higher tax liability to State employment security agencies. Employees pay up to 6.2 percent of payroll for FUTA. 5.4 percent of that amount is paid to the States for the payment of benefits.

Imposition of the FUTA tax for H2–A workers would result in yet another regulatory burden for farmers. Not only is there the direct cost of the FUTA tax to consider, but also the indirect cost of additional recordkeeping and reporting responsibilities.

For these reasons, Congress should make the H2–A FUTA tax exemption permanent. H2–A workers will never be able to meet the ready, willing and available test to receive benefits, even if taxes are paid for them.

I thank you for the opportunity to testify here today. If you have any questions, I would be willing to try to answer them.

[The prepared statement follows:]

STATEMENT OF THE AMERICAN FARM BUREAU FEDERATION

Presented by
C. Wayne Ashworth
President, Virginia Farm Bureau

Madame Chairman, members of the Oversight Subcommittee, I want to thank you for the opportunity to appear before you today representing the American Farm Bureau Federation. I am Wayne Ashworth, President of the Virginia Farm Bureau. Virginia Farm Bureau represents more than 114,000 member families. I have been involved in Farm Bureau in one capacity or another since 1963.

The American Farm Bureau is the nation's largest general farm organization. Farm Bureaus in all 50 states and Puerto Rico represent some 4.4 million member families nationwide. Farm Bureau's farm and ranch members are engaged in the production of virtually every agricultural commodity grown commercially in the United States.

I am here to present the views of the American Farm Bureau Federation on Federal Unemployment Tax Act (FUTA) and Unemployment Insurance (UI) coverage of temporary alien agricultural workers admitted to the United States under the H-2A program.

When the UI program was created, agricultural employers were exempt. In 1976, the federal law was changed to extend eligibility to employees of certain agricultural employers.

When UI coverage was extended to agricultural workers, and FUTA payroll taxes were likewise extended to their employers, temporary alien workers were also exempted from FUTA taxes.

H2-A workers are admitted to the United States under Section 101(a)(15)(H)(2)(a) of the Immigration and Nationality Act to perform agricultural labor tasks, generally for limited periods of time. H-2A workers are employed across the United States: they work in tobacco, apples and vegetables in my home state of Virginia, and in the states of Kentucky and Tennessee; they work in tobacco and vegetables in North Carolina; they work in fruit, vegetables and nursery crops in New England and New York; and they are employed in sheepherding in twelve western states including North Dakota, South Dakota, Wyoming, Montana and California.

The policy resolutions adopted by the elected voting delegates of the member state Farm Bureaus at the 76th annual meeting of the American Farm Bureau Federation in January 1995 specifically addressed the issue of FUTA coverage for H-2A workers and opposed the imposition of federal unemployment insurance payroll taxes on H-2A employers.

Farm Bureau policy is clear in its opposition to extending UI to H-2A workers and requests that the H-2A/FUTA exemption be extended permanently. The H-2A/FUTA exemption has been granted for specified periods of time, usually two to three years. The most recent exemption expired on January 1, 1995.

There are several reasons why UI should not be extended to H-2A workers. H-2A workers must return to their home countries at the conclusion of their employment, and cannot remain unless they have secured additional employment with an H-2A certified employer. Due to their immigration status as temporary

alien agricultural workers, H-2A workers are unable to meet the statutory unemployment eligibility test of being willing, able, and available to work. To force employers of H-2A workers to pay into the UI system would only serve to undermine the insurance feature of the program. In effect, employers would be forced to pay for insurance protection for their employees against financial loss associated with unemployment, despite the fact that no such injury can occur.

In addition, there is little in the way of additional revenue to the federal Unemployment Trust fund to be realized if FUTA taxation is extended to the wages of H-2A workers. As I mentioned before, employers are required to pay a FUTA tax of 0.8 percent of the first $7,000 an employee earns (the taxable wage base). If 15,000 H-2A workers in any given year (in 1993, the U.S. Department of Labor certified 17,000 H-2A slots) earned as much as the taxable wage base of $7,000, their employers' tax liability to the federal government under FUTA would be approximately $56 per worker. Therefore, the total collected from the H-2A FUTA tax at the federal level would be $840,000. Extension of FUTA to H-2A workers does not result in a tax windfall for the federal government, but does entail additional compliance requirements for farmers.

Employers would be responsible for a significantly higher tax liability to state employment security agencies; employers pay up to 6.2 percent of payroll for FUTA, based on their experience rating; 5.4 percent of that amount is paid to the states for the payment of benefits. Thus, employers would be subject to a significant state tax liability for Unemployment Insurance (which would vary somewhat by jurisdiction) should Congress fail to correct the law to exempt H-2A wages from FUTA.

Imposition of the FUTA tax for H-2A workers would result in yet another regulatory burden for farmers. Not only is there the direct cost of the FUTA tax to consider, but also the indirect costs of additional record keeping and reporting responsibilities. These added costs for farmers, unlike most other business operations, cannot be readily recouped in the form of higher prices for farm commodities. Unfortunately, farmers do not set commodity prices, the marketplace does. When prices are low, all the farmer can do is withhold commodities from the market in hopes of a better price at a later date. With highly perishable commodities, a farmer is only able to withhold commodities from the market for a very short period of time, if at all. If farmers are unable to recoup the added cost of FUTA taxes, it is a direct hit on net farm income. For perishable crops, margins are already razor thin.

For these reasons, Congress should make the H-2A/FUTA tax exemption permanent. H-2A workers will never be able to meet the "ready, willing, and available" test to receive benefits, even if taxes are paid for them.

Thank you for the opportunity to testify. I look forward to answering any questions you may have.

Mr. HERGER. Thank you very much, Mr. Ashworth.
Mr. Young, if you would testify, please.

STATEMENT OF JOHN H. YOUNG, PRESIDENT, NATIONAL COUNCIL OF AGRICULTURAL EMPLOYERS

Mr. YOUNG. Mr. Chairman and Members of the Oversight Committee, I want to thank you for giving me the opportunity to testify before you today representing NCAE, the National Council of Agricultural Employers.

I am John Young, president of the National Council of Agricultural Employers, and executive director of the New England Apple Council, a member of NCAE. I am also the owner and operator of Mapadot Farm, an apple orchard in New Boston, New Hampshire. We rely on the H2–A Program to secure apple pickers for our annual harvests, as do most of the members of the New England Apple Council.

The National Council of Agricultural Employers is the only national association focusing solely on farm labor and immigration issues from the farm management point of view. Our membership includes agricultural employers in 50 States who employ approximately 75 percent of the agricultural work force in the United States. NCAE's members include farm cooperatives, growers, packers, processors and agricultural associations. NCAE represents virtually all of the more than 3,000 employers who use the H2–A temporary agricultural worker program.

The H2–A worker program is the program under which aliens are admitted temporarily to perform agricultural work in the United States. Employers only become eligible to use the H2–A program after the U.S. Department of Labor has certified that sufficient U.S. workers are not available to fill their jobs.

The H2–A aliens are admitted to work for a specific employer for the duration of a specific temporary or seasonal agricultural job such as apple harvesting in my own case. After the H2–A alien completes the work contract for which he was admitted, he is then required to return to his or her home country, unless the stay is extended to work on another H2–A contract.

The payrolls of H2–A aliens (then called H2) were exempted from FUTA taxes when the unemployment insurance coverage was first extended to agricultural employers in 1976. The H2–A workers, along with most other categories of nonimmigrant aliens, were excluded from UI benefits by the same legislation. Congress has regularly renewed the H2–A FUTA tax exemption, most recently through December 31, 1994.

The exemption of H2–A payrolls from FUTA taxes is entirely consistent with the "insurance" concept which is at the heart of the UI program. Even if H2–A workers were not statutorily excluded from UI benefits, they would nevertheless be ineligible to receive benefits because they cannot remain in the United States and meet the availability for work test once they leave the employ of the employer who petitioned for their initial admission or extension of stay. It is not reasonable to require employers to pay premiums to protect workers who are barred from receiving the benefit the premiums purchase. Congress should, in fact, make the FUTA exemp-

tion on H2–A payrolls permanent, as it did with the H2–A exemption from FICA taxes, for which the same rationale applies.

My fellow panelist has pointed out that the revenue that would be added to the Federal coffers, if this exemption is not continued, is very small, well under $1 million. The total added cost to the affected farmers of imposing this tax is not reflected in the Federal portion. Most State laws exclude from State unemployment taxes the same payrolls that Federal law excludes from Federal taxation. The added State UI tax burden that farmers would incur by ending this exemption is substantial. For many farmers, it would amount to an immediate increase of more than 6 percent in their payroll costs because of the high UI experience rating resulting from the seasonal nature of farm work.

It is sometimes argued that H2–A payrolls should be taxed, even though H2–A aliens cannot receive UI benefits, in order to equalize employers tax obligations for U.S. and alien workers or to preclude an incentive to employ aliens or to discourage employers from employing them. This argument fails on two grounds.

First, H2–A aliens are already very expensive, as reflected by the low level of use of the program—about 17,000 H2–A aliens employed nationwide in 1994. The range of benefits farmers are required to provide in job opportunities certified for employment of H2–A workers is substantially above that received by the average U.S. farm worker. Added to this is the substantial cost of transportation and housing of the H2–A. The high cost of the H2–A program is the reason most frequently cited by farmers for the current low use of the program.

Second, it is not the role of the unemployment insurance program to seek to "discourage" employers from employing H2–A workers, when sufficient qualified domestic workers are not available to fill employers' job opportunities.

This is particularly true, given that Congress has throughout the history of U.S. immigration law taken the position that provisions for the temporary employment of aliens are needed and are in the national interest. If the unemployment insurance program is expanded from an insurance-based program for compensating workers who have temporary periods of involuntary unemployment into a program for advancing other agendas, the very integrity of the system and the protections it affords to working men and women will be threatened.

I urge the Subcommittee and the Congress to permanently exempt the payrolls of H2–A workers from FUTA taxes retroactive to January 1, 1995. Thank you for your attention, and I will be happy to respond to questions.

Mr. HERGER. Thank you very much.

Ms. Meyers.

STATEMENT OF ABBEY S. MEYERS, PRESIDENT, NATIONAL ORGANIZATION FOR RARE DISORDERS, INC., NEW FAIRFIELD, CONNECTICUT

Ms. MEYERS. Thank you.

I am Abbey Meyers, president of the National Organization for Rare Disorders, which is known as NORD. We are a group of approximately 135 national voluntary health agencies concerned

about orphan diseases, and we worked together in the early eighties to help pass the Orphan Drug Act of 1983. This law has become one of the most successful Federal laws passed by Congress in the last 20 years. It has created financial incentives to entice pharmaceutical manufacturers into developing drugs that ordinarily have little commercial value.

One of these incentives is a tax credit which is 50 cents on every dollar a company spends to develop a drug for a rare disease. These drugs are sold to very small populations of people and they ordinarily would cost more to develop than they would make a profit once it is on the market. It allows companies to save 50 cents out of every dollar that they spend on clinical trials. It is an extraordinarily important law, but every few years this tax credit expires and then Congress has to determine when it is going to reauthorize the tax credit, and it is usually months to a year or more before this reauthorization occurs.

We would like to see the orphan drug tax credit made permanent in the Tax Code, because it would give certainty to companies who cannot now make a decision as to whether to invest in an orphan drug's development, if they do not know whether they are going to have the tax credit every year when the credit expires.

We also feel it is extremely important that they carry forward the tax credit, because many of the orphan drug companies are small pharmaceutical and biotechnology companies that are not yet profitable and, therefore, they cannot use the tax credit. They cannot sell it, they cannot trade it, and they cannot use it until they become profitable. If they could carry that credit forward to future years when they are profitable, it would help enormously, especially in the biotechnology field, where the most promising treatments for genetic diseases would be developed. It would really help to encourage other companies to get involved with orphan drug development.

Eventually, we would like to see that tax credit cover preclinical research, too, but it is most imperative now that we reauthorize this credit immediately to make sure that companies do not lose the credits that expired in 1994.

I also have to say that Japan passed an Orphan Drug Act last year. The European Union will be passing an Orphan Drug Act within the next 2 years. We have to stay competitive with these other countries and make sure that the incentives of the Orphan Drug Act are strengthened, because there will be a large amount of competition in the near future in this area, and orphan drugs are a very important export of the United States.

Thank you.

[The prepared statement follows:]

STATEMENT OF ABBEY S. MEYERS
PRESIDENT, THE NATIONAL ORGANIZATION FOR RARE DISORDERS, INC

Madam Chairman and Members of the Subcommittee:

Good afternoon, I am Abbey Meyers, President of the National Organization for Rare Disorders, Inc. (NORD). NORD is a national non-profit voluntary health agency that represents the 20 million Americans who suffer from over 5,000 rare diseases and disorders. NORD's membership includes 138 national voluntary health organizations and support groups dedicated to the identification, treatment and cure of rare "orphan diseases."

An orphan disease is a condition that affects fewer than 200,000 Americans. Hereditary diseases account for approximately 4,000 of these 5,000 little known diseases. Because so few people are affected by each disorder, the pharmaceutical industry is reluctant to develop drugs to treat such illnesses due to the limited potential for profit. However, combined together rare diseases affect an estimated 20 million people in the United States alone, clearly adding major financial burdens to our nation. More importantly, the absence of effective treatments for these ailments causes severe disability and needless death among our fellow Americans.

The Orphan Drug Act of 1983

When I first testified before Congress fifteen years ago, rare disease patients were literally being "orphaned" by doctors, researchers, and pharmaceutical firms, and even by our government. Since drug companies would not manufacture treatments, scientists were not interested in spending years researching compounds that may never make it to the market. In 1983, Congress passed the **Orphan Drug Act** aimed at solving the orphan drug dilemma. It provided economic incentives to entice pharmaceutical companies into developing drugs of "limited commercial value" to treat or cure rare diseases. Finally, millions of profoundly desperate patients were given the hope that they so critically needed.

The Act has been enormously successful. During the ten years prior to the enactment of the law, only ten orphan products were developed by the industry. In the twelve years since, approximately 600 orphan products have been designated by the Food and Drug Administration (FDA) and 111 have been approved for marketing.

The Orphan Drug Tax Credit

One of the major incentives of the Orphan Drug Act is a tax credit of 50 cents on every dollar that a company spends for clinical research to develop an orphan drug. This was seen as a very necessary and positive way to attract companies into this field of research and development. However, the tax credit has had a very limited impact for several reasons. First, it expires every couple of years -- forcing Congress to spend valuable time deciding whether or not to grant reauthorization, and if so, whether the credit should be made retroactive to the date when it expired. This is why we are here today. These recurring gaps in the very existence of the orphan drug tax credits bring a great deal of uncertainty to manufacturers who are already hesitant to launch expensive clinical trials. Furthermore, such an uncertain fate tends to scare away prospective investors who are needed to provide the start-up capital for this research.

Therefore, the National Organization for Rare Disorders, Inc. (NORD) recommends that the Orphan Drug Tax Credit be made permanent, or at least extended for another five years.

Another reason for the limited impact of the tax credit involves its narrow application. Many small companies that are not yet profitable cannot use the tax credit because it cannot be carried forward to a profitable year. Therefore, the companies which are best suited to develop treatments for rare genetic disorders, the biotechnology industry, very often cannot use the tax credit. It is important to note that just last month, the Director of the National Institutes of Health (NIH) submitted a report to the Senate, entitled "Gene Therapy on Hereditary Rare Diseases". This NIH report strongly contends that biotechnology and gene therapy are the areas of scientific research which offer the most promise for discovering safe and effective treatments for the vast majority of rare orphan diseases. Everyone agrees that it is wise to invest in research where the technology actually has the highest probability of succeeding. The ability of a small company to carry the orphan tax credit forward is just that -- a smart investment in the most promising research.

According to the Department of the Treasury, only $18 million was claimed during 1992 by the pharmaceutical industry in orphan drug tax credits. This relatively tiny sum was claimed mostly by large multinational companies. When we look at the big picture, this small amount claimed indicates how little they invested in orphan drug research. The lions share of orphan drug development is being performed by small pharmaceutical and biotechnology companies because they are willing to develop products that have smaller annual sales. We believe that the orphan tax credit should be restructured to provide these innovative companies (and their investors) with at least some degree of certainty about such important business ventures in the interest of the public health.

Therefore, the National Organization for Rare Disorders, Inc. (NORD) recommends that companies be allowed to carry the Orphan Drug Tax Credit forward to a profitable year.

A third reason the orphan credit has not shown greater results is because it may only be applied to the costs incurred for clinical research, in other words human trials. Essential pre-clinical trials -- such as expensive toxicology tests -- are not covered by the orphan credit. The U.S. National Commission on Orphan Diseases, in its 1989 report to Congress, recommended that the tax credit should be applicable to such pre-clinical testing.

Therefore, the National Organization for Rare Disorders, Inc. (NORD) recommends that the Orphan Drug Tax Credit be applied to pre-clinical research costs.

Madam Chairman, while others may offer further suggestions for the restructuring of the orphan drug tax credit, NORD does not. For example, we do not support the expansion of the tax credit to cover post marketing R&D. We believe that once a drug is approved and on the market and a company wants to study it for another orphan disease, then an orphan drug designation may be obtained for that new use. The tax credit would then apply to that new clinical research.

Anyone familiar with NORD's position on pharmaceutical issues throughout the years realizes that we do not shy away from criticizing the drug industry when necessary and we do not believe that the Orphan Drug Act is perfect. There have been a few problems. Three or four companies have developed drugs that have become extraordinarily profitable. We feel that these cases represent abuses of the intent of the law and we have recommended that Congress change the Act to prevent future abuses. However, that is a separate issue from the tax credits.

The fact is, more than 100 of the 111 orphan drugs on the market are **true** orphan products that have limited commercial value in comparison to drugs for prevalent diseases like arthritis or hypertension. Without orphan drug incentives, companies will choose to invest their limited resources in research and development of only the most profitable drugs for prevalent diseases. Orphan drugs on the market today include drugs for Wilson's disease, lead poisoning, dystonia, carnitine deficiency, porphyria and other diseases that have never been heard of by most people. Clearly, these treatments would not have been developed without the incentives of the Orphan Drug Act.

Madam Chairman, the National Organization for Rare Disorders celebrates one of the newest drugs to reach the market. Twenty years ago, academic scientists were studying a rare hereditary kidney disease, Cystinosis, which killed children during adolescence. They discovered that the drug cysteamine could prevent these children from losing their kidneys and going blind. Over the next two decades, the scientists searched for and indeed begged manufacturers to adopt this drug, but no company was interested because less than 300 children in the United States have Cystinosis. The scientists could not allow the children to die, so they continued to buy the raw chemicals and distribute cysteamine as an investigational drug. Periodically, they would run out of money and would have to beg and borrow in order to find the resources to keep the experimental treatment available. Finally, a generic drug company stepped forward and agreed to produce this treatment in a form which made FDA marketing approval possible. Today, children with the fatal hereditary metabolic disease, cystinosis, have been given a new life because the orphan drug, Cystagon, is now available from Mylan Pharmaceuticals.

Many more orphan drugs would be developed if manufacturers could rely on dependable tax credits that won't expire when they least expect it. Orphan drug development is an area where the government plays a vital role by meeting a societal need that is not being met by the private market. There is much more our government can do to alleviate suffering, and avoid disability and death if the orphan drug tax credit can be enhanced.

Madam Chairman, the United States is running the risk of falling behind in the highly competitive world of medical technology. By way of comparison, Japan enacted an Orphan Drug Act in 1994. During this first year, the Japanese have already approved 50 new rare disease protocols. The Japanese government subsidizes 50% of the cost of all research on all new orphan drug products, totaling several millions of dollars each year. Germany has reserved $840 million in an annual fund to support biotechnology research. Last year they solicited applications for funding of 30 gene therapy protocols, but they received 180 applications for those funds, mostly for rare genetic diseases. France allocated $50 million for gene therapy research last year, but the United States has reserved zero. The European Union (EU) has set aside $336 million for pharmaceutical R&D, encompassing nine priority areas (Article 20, Treaty of European Union). One of those priority areas is rare diseases. This year, the EU is drafting orphan drug legislation more expansive than ours -- with 10 years of market exclusivity and a wider definition of orphan status.

In our opinion, the Orphan Drug Act is the most significant piece of health care legislation in the last two decades. We are very pleased that the President indicated his support for the extension of the orphan drug tax credit in his FY'96 Budget Request to Congress earlier this year. We fully support the enactment of **H.R. 1566 "The Orphan Drug Tax Credit Amendments of 1995"**, recently introduced by Chairwoman Johnson and the ranking minority member of this subcommittee, Mr. Matsui. This legislation takes a first step in the right direction by 1) extending the tax credit permanently and 2) by allowing companies to carry the credit forward to a profitable year.

Madam Chairman, we appreciate having the opportunity to present our views before this Subcommittee. We offer our continued advice and support to you and your staff. Thank you.

Mr. HERGER. Thank you very much, Ms. Meyers, for your testimony.

Ms. Raines.

STATEMENT OF LISA RAINES, VICE PRESIDENT, GOVERNMENT RELATIONS, GENZYME CORP., CAMBRIDGE, MASSACHUSETTS; ON BEHALF OF BIOTECHNOLOGY INDUSTRY ORGANIZATION

Ms. RAINES. Thank you, Mr. Chairman.

My name is Lisa Raines and I am vice president of Genzyme Corp., a biotechnology company headquartered in Cambridge, Massachusetts. I am here today both on behalf of my company and the BIO, Biotechnology Industry Organization, which represents more than 570 biotechnology companies, State university centers and related organizations in 47 States.

Mr. Chairman, the biotechnology industry strongly supports enactment of H.R. 1566, Mrs. Johnson's bill to make the orphan drug tax credit permanent and to amend it so that the credit can be carried forward in the same way that the research and experimentation credit can be carried forward. This legislation will facilitate increased research into drugs to treat rare diseases for which no treatment is available, particularly by the small biotechnology companies that currently perform about half of all orphan drug research.

In the 10 years prior to the enactment of the Orphan Drug law, only seven drugs were approved by the Food and Drug Administration for treatment of rare diseases. In the 12 years since enactment, over 100 drugs have been approved for marketing, and about 600 are in various stages of development. This is concrete objective evidence of the success of the orphan drug program, perhaps one of the most clearly successful programs that Congress has enacted in the last 20 years.

My company Genzyme was the first and only company to develop an FDA, Food and Drug Administration, approved treatment for Gaucher disease, a severely debilitating and sometimes fatal genetic disorder with a worldwide patient population of under 5,000. We are now developing orphan drugs for a number of other rare diseases, including a variety of genetic diseases and rare cancers.

Still there is more research that needs to be done for the 20 million Americans that suffer from one of about 5,000 rare diseases. By reducing the risk and cost of developing treatments for millions of seriously ill Americans, the orphan drug tax credit plays an important role in creating an incentive for private companies to tackle these diseases.

Since the enactment of the orphan drug tax credit in 1983, it has been temporarily extended four times, most recently until December 31, 1994. It has since expired, thereby effectively increasing the cost of orphan drug research and reducing the incentive to developing orphan drugs.

The effectiveness of the tax credit to encourage the development of products that take 10 to 12 years to develop is compromised if companies cannot depend on it to last through the entire clinical development process. Uncertainty about the availability of the credit for the entire process has almost certainly led some compa-

nies to conclude that they cannot afford to develop orphan drugs. In the absence of these treatments, ineffective yet expensive health care interventions will continue to be a cost to the taxpayer.

H.R. 1566 would make the orphan drug tax credit permanent, and by reducing uncertainty about the net aftertax cost of orphan drug development, this legislation would better enable companies to financially commit themselves to the lengthy and arduous process of developing these products.

In fact, my company is prepared to make the following public commitment. If the orphan drug tax credit is made permanent, we will reinvest every cent of the tax savings attributable to the credit in orphan drug research. While no company can forecast its future circumstances or where scientific advances may take us, we do feel confident that we can keep this commitment for the foreseeable future.

In addition to making the credit permanent, we believe that the credit should be restructured as is provided in the bill to permit companies to carry the credit forward or back. Under the credit's existing structure, a company can only claim the credit if it has incurred corporate income tax liability in the same year as the credit is earned. It has to be used or lost that same year.

Of course, if the company loses money that year so it has no current tax liability, then it loses the credit forever. This is what happens to most biotechnology companies. It happened to my company for the first 10 years it was in existence. The last 2 years have been the first 2 that we have actually been able to use the credits that we have earned.

Restructuring the orphan drug tax credit to permit carryforward and carrybacks would also make it more closely resemble the research and experimentation tax credit on which it was modeled. Not only would such a restructuring increase consistency among two similar tax credits, it would eliminate the orphan drug credit's current discrimination against small development stage biotech companies at the same time as it increases the incentive for these companies to invest in orphan drug development.

Thank you for the opportunity to express the biotechnology industry's views.

[The prepared statement follows:]

STATEMENT OF LISA RAINES
VICE PRESIDENT FOR GOVERNMENT RELATIONS
GENZYME CORPORATION, CAMBRIDGE, MASSACHUSETTS

Madam Chairman and members of the Subcommittee, my name is Lisa Raines and I am vice president for government relations of Genzyme Corporation, a biotechnology company based in Cambridge, Massachusetts. I am here today on behalf of both Genzyme and the Biotechnology Industry Organization (BIO), which represents more than 570 biotechnology companies, state biotechnology centers, and related organizations in 47 states and more than 20 countries.

The biotechnology industry strongly supports enactment of H.R. 1566, a bill to make the orphan drug tax credit permanent and to amend it so that the credit can be carried forward in the same way that the research and experimentation credit can be carried forward. This legislation will facilitate increased research into drugs to treat rare diseases for which no current treatment is available, particularly by the small biotechnology companies that currently perform about half of all orphan drug research.

I am pleased to note that this bill is being offered on a bipartisan basis by the Chairwoman, Mrs. Johnson, and the ranking minority member of this subcommittee, Mr. Matsui. This legislation enjoys the support of both the patient and provider communities, it has no known opposition, it is consistent with the President's call on Congress to extend the orphan drug credit, and it would have a minimal impact on federal revenue receipts. The biotechnology industry urges swift enactment of the Johnson-Matsui bill.

Success of the Orphan Drug Legislation

The Orphan Drug Act is unanimously recognized as one of the most effective pieces of legislation enacted by Congress in the last twenty years. The Act provides a variety of incentives for companies to develop drugs with limited commercial potential to treat patients with rare diseases, which are defined by law as conditions affecting fewer than 200,000 Americans.

In the ten years prior to enactment of the orphan drug law, only seven drugs were approved by the Food and Drug Administration (FDA) for treatment of rare diseases. In the twelve years since enactment, over 100 drugs have been approved for marketing and approximately 600 drugs are in various stages of development.

My company, Genzyme, was the first and only company to develop an FDA-approved treatment for Gaucher disease, a seriously debilitating and sometimes fatal genetic disorder with a worldwide patient population of under 5,000. We are now developing orphan drugs for a number of other rare diseases, including genetic diseases (cystic fibrosis and Fabry disease) and rare cancers (myelogenous leukemia, thyroid cancer, and Kaposi's sarcoma).

Still, there is more research that needs to be done for the 20 million Americans that suffer from one of about 5,000 rare diseases. By reducing the risk and cost of developing treatments for millions of seriously ill Americans, the orphan drug tax credit plays an important role in creating an incentive for companies to tackle these diseases.

Orphan Drug Tax Credit Amendments (H.R. 1566)

Bringing a new drug for a rare disease from bench to bedside is a lengthy and expensive process which typically consumes ten to twelve years of research costing many millions of dollars. The effectiveness of a tax credit to encourage the development of such products is compromised if companies cannot depend on it to last through the entire clinical development process.

Since enactment of the orphan drug tax credit in 1983, it has been temporarily extended several times, most recently until December 31, 1994. It has

since expired, thereby effectively increasing the cost of orphan drug research and reducing the incentive for developing orphan drugs. Uncertainty about the availability of the credit for the entire clinical development process has almost certainly led some companies to conclude that they cannot afford to develop orphan drugs.

H.R. 1566 would make the orphan drug tax credit permanent. By reducing uncertainty about the net, after-tax cost of orphan drug development, this legislation would better enable companies to financially commit themselves to the lengthy and arduous process of developing orphan drugs. In fact, my company is prepared to make the following commitment: If the orphan drug tax credit is made permanent, we will reinvest every cent of tax savings attributable to the credit in orphan drug research. While no company can forecast its future circumstances or where scientific advances may take us, we feel confident that we can keep this commitment for the foreseeable future.

In addition to making the credit permanent, we believe that the credit should be restructured -- as is provided in H.R. 1566 -- to permit companies to carry the credit forward or back. Under the credit's existing structure, a company can only claim the credit if it has incurred corporate income tax liability in the same year as the credit is earned. If the company loses money that year, so that it has no current tax liability against which the credit can be offset, then the credit is lost forever.

Restructing the orphan drug tax credit to permit carryforwards and carrybacks would make it more closely resemble the research and experimentation tax credit, which can be "saved" and applied to a company's future tax liability. Not only would such a restructuring increase consistency among two similar tax credits, it would eliminate the orphan drug credit's current discrimination against small, development-stage biotechnology companies at the same time as it increases the incentive for these companies to invest in orphan drug development.

Most small biotech firms have yet to bring their first product to market. Until its first product receives FDA approval and begins generating revenues, a small company will generally be unprofitable. Since unprofitable companies have no current tax liability against which to utilize the orphan drug credit, these companies get no benefit from the credit. Yet some small biotech companies perform more orphan drug research than some large pharmaceutical companies that have tax liabilities against which to offset their credit. Restructuring the credit would eliminate this tax inequity between large and small companies, while providing both with an important incentive to include orphan drugs in their research portfolios.

Making the tax credit permanent and restructuring it so that the credit can be used in tax years other than the one in which it was earned has been scored by the Joint Committee on Taxation to cost $157 million over the next five years. Such an amount is a small investment to provide an incentive for research that can be so effective in improving the quality of life of so many.

Other Proposals for Restructuring the Orphan Drug Tax Credit

While the biotechnology industry supports enactment of H.R. 1566 as drafted, we would like to encourage you to consider the addition of two additional restructuring proposals.

First, the credit could be made available for preclinical research, which is the laboratory and animal research that necessarily precedes human testing. Such preclinical research is fundamental to the discovery process of orphan drugs. As currently structured, the credit only applies to clinical (human testing) research.

And second, the credit could be made available for orphan drug clinical research that is conducted after the product receives FDA approval. Contrary to popular belief, clinical research does not end when a product is approved for marketing. For example, companies typically continue to conduct clinical trials to better understand the effect of different dosing regimens. In addition, FDA strongly encourages companies to conduct pediatric clinical trials with approved drugs so that they can be dosed appropriately for children. Similarly, a drug that is approved to treat one form of cancer may be tested against a second type of cancer. As currently structured, none of these post-approval clinical trials would be eligible for the credit.

Conclusion

Madam Chairman, I thank you for inviting me to testify before this Subcommittee. I would be happy to answer any questions.

Mr. HERGER. Thank you for your testimony.
Mr. Joseph.

STATEMENT OF JAMES A. JOSEPH, PRESIDENT AND CHIEF EXECUTIVE OFFICER, COUNCIL ON FOUNDATIONS

Mr. JOSEPH. Mr. Chairman, I am James A. Joseph, president and chief executive officer of the Council on Foundations. The council is a nonprofit charitable membership association of grant-making foundations and corporations. Our members number almost 1,400. Together they hold the bulk of the assets of the foundation community and make the bulk of that community's charitable grants each year.

I am pleased to testify today in support of permanent restoration of the highly important tax provision enacted in 1984 and sunsetted at the end of last year which permitted living donors to deduct the full value of publicly traded stock given to private foundations. Our experience strongly suggests that if the deduction is not restored, this critically important class of charitable giving will virtually disappear.

America's private foundations contribute more than $10 billion annually to charitable organizations large and small that advance scientific and medical research, strengthen the American educational system, help the poor and disadvantaged, and provide disaster relief, to name just a few of the multitude of charitable purposes of foundation grants.

Mr. Chairman, I have attached to my statement a document we call "Philanthropy's Great Grants," which tells the story of several important uses of private foundation grants. The expired charitable deduction before the Subcommittee, if restored, will provide a powerful incentive for Americans to make permanent conversions to charitable use of stock now held solely for private and personal benefit.

I would like to briefly highlight five good reasons to restore this charitable deduction. First, with pending government cutbacks in spending, the importance of giving to private foundations is greater than ever. While foundations clearly do not have the capacity to replace the likely spending cuts, they can provide invaluable assistance in the coming transition. Now more than ever, it is important to stimulate giving to foundations.

The second reason is that the expired charitable deduction has proven effective in stimulating increased giving. When the full value deduction for gifts of publicly traded stocks to private foundations was reinstated in 1984, lifetime giving to foundations skyrocketed.

The third reason is that the public charitable benefit far outweighs any revenue losses. Reinstatement of this deduction will generate benefits to charitable enterprises and the public far greater than any estimate of its effect over the next several years can suggest.

The fourth reason, IRS and Treasury have reported no problems or evidence of abuse. From time to time, Congress has expressed concern about the potential overvaluation of gifts to charity. It is important to emphasize to this Subcommittee that the charitable

deduction under consideration here permits full value deductions only for gifts of publicly traded stock.

The fifth and final reason, restoring the deduction will accelerate charitable benefits and produce more effective new foundations. In sum, Mr. Chairman, restoring the charitable deduction for gifts of publicly traded stock to private foundations presents a rare opportunity to transform substantial wealth now held for personal purposes to a major resource permanently dedicated to the support of sound and creative charitable works. For this reason and many others, I strongly urge you to renew this deduction and to make it a permanent part of the IRC.

Thank you very much for this opportunity to testify before you.

[The prepared statement and attachments follow:]

Statement of

JAMES A. JOSEPH
PRESIDENT AND CEO
COUNCIL ON FOUNDATIONS

Madame Chair and Distinguished Members of the Subcommittee:

Good morning, I am James A. Joseph, President and CEO of the Council on Foundations. The Council is a nonprofit, charitable membership association of grantmaking foundations and corporations. Our members now number over 1,375. Together they hold the bulk of the assets of the foundation community and make the bulk of that community's charitable grants each year.

I am pleased to testify here today in support of permanent restoration of the highly important tax provision, enacted in 1984 and sunseted at the end of last year, which permitted living donors to deduct the full value of publicly traded stock given to private foundations.[1] With the expiration of that provision, donors may now deduct only the cost basis of such gifts of stock. Our experience strongly suggests that, if the deduction is not restored, this critically important class of charitable giving will virtually disappear.

The Unique Contribution of Private Foundations

America's private foundations contribute more than $10 billion annually to charitable organizations, large and small, that advance scientific and medical research, strengthen the American educational system, help the poor and disadvantaged, and provide disaster relief -- to name just a few of the multitude of charitable purposes of foundation grants.[2]

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1 Section 170(e)(5).

2 Attachment I to this statement, entitled About Foundations provides more data on the capacity and limitations of foundations and their role in the charitable sector. For simplicity, the references throughout this statement which mention giving to "private foundations" or to "foundations" are contributions to grantmaking, nonoperating private foundations which constitute the great preponderance of all private foundations. Different charitable deduction rules apply to contributions given to foundations classified as "operating" or "pass-through" private foundations.

Private foundations have made major improvements in American life throughout the 20th century. They have, for example, been responsible for:

... The Salk polio vaccine
... The pap smear
... The cure for yellow fever
... Sesame Street
... The Emergency 911 response system

I have attached to my statement a document we call Philanthropy's Great Grants which tells the story of these and several other important uses of private foundation grants.[3]

The expired charitable deduction before the Subcommittee this morning -- if restored -- will provide a powerful incentive for Americans to make permanent conversions to charitable use of stock now held solely for private and personal benefit.

FIVE GOOD REASONS TO RESTORE THIS CHARITABLE DEDUCTION

#1-- With Pending Cutbacks in Government Spending, the Importance of Giving to Private Foundations Is Greater Than Ever

Foundation giving at roughly $10 billion a year is small in comparison to total U.S. charitable giving of over $120 billion or in comparison to a $1.5 trillion federal budget. Yet foundations are uniquely structured to readjust priorities, accommodate to change and refocus their support on emerging needs. The genius of foundations is to be found in the quality of their grantmaking rather than in the quantity of their resources.

Changes in governmental funding will -- of necessity -- force many American charities to reassess their capacity to respond. Such charities, both new and well-established, benefit greatly from being able to look to private foundations for assistance in going through such a transition. Because of their independence, foundations can provide the "research and development" funds for new and more efficient modes of coping with the problems that will confront these charities. Equally important, foundations have already proven themselves adept at working with government to streamline service delivery and discover cost-effective alternatives to traditional approaches. The heightened budgetary pressures on government will greatly increase the need for such work.

In short, while foundations clearly do not have the capacity to replace the likely spending cuts, they can provide invaluable assistance in the coming transition. Now, more than ever, it is important to stimulate giving to foundations.

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3 Attachment II.

#2 -- The Expired Charitable Deduction Has Proven Effective in Stimulating Increased Giving

Going well beyond the reforms recommended by Treasury in 1965, the Tax Reform Act of 1969 -- for the first time -- limited to the donor's cost basis the amount of charitable deduction that could be claimed for gifts of appreciated property to private foundations. The impact on lifetime giving to private foundations was devastating. Data compiled by The Foundation Center indicates that the rate of formation of new private foundations in the 1970s dropped over 42 percent -- from an average of 137 per year in the 1960s to 79 per year in the 1970s.[4] There is uniform agreement among practitioners in the field that most of the foundations formed in the 1970s were by bequest -- non-bequest giving simply dropped dramatically.

The full value deduction for gifts of publicly traded stock to private foundations was reinstated in 1984. Lifetime giving to foundations rebounded. Indeed, the 1980s and early 1990s brought a sharp reversal of the experience of the 1970s -- and a substantial increase in the number of new private foundations formed. According to The Foundation Center, the average number of private foundations formed in the 1980s grew to 246 per year compared to only 79 per year in the 1970s. One state -- Michigan -- has already identified over 50 new foundations formed in the past six years with publicly traded stock. The impact of the restored deduction could hardly be clearer.

As the 10-year life of the deduction was nearing its end in 1994, the Council on Foundations received an unprecedented number of phone calls from all across the country. The callers were attorneys, accountants, estate planners and other professionals who all had numerous clients wanting to give publicly traded stock to private foundations. No data is yet available to measure the number of private foundations formed at the end of 1994 as the sun set on the deduction, but we know there were many.

We need not guess, then, at the effectiveness of the charitable deduction for encouraging contributions of publicly traded stock to private foundations. When full deductibility was not in effect, very few foundations were created during donors' lifetimes. When full deductibility was reinstated in the law, lifetime giving responded promptly and markedly. The full deduction has plainly proved its worth.

#3 -- Public Charitable Benefit Far Outweighs the Revenue Loss

The Joint Committee estimates that restoring this deduction will produce a revenue loss of $286 million over the remaining part of the current fiscal year and the next five years. If the capital gains tax reduction included in the House-passed Contract with American becomes law, the revenue loss would drop by more than half of that amount to $128 million.

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4 Foundation Giving (1994 Edition), p. 27. Figures are for foundations with $1 million or more in assets or making grants of $100,000.

If the Joint Committee's revenue loss numbers are accurate, donors will be contributing appreciated stock to foundations in excess of $1 billion over the period of the estimate -- or roughly $200 million per year on average. Those figures, however, considerably understate the benefit that charity will realize from the restored deduction in the intermediate and longer term.

Our experience indicates that donors who create private foundations during their lifetimes --- and see for themselves the year-to-year good that foundations can accomplish --- are far more likely to make substantial bequests to their foundations at death than are well-to-do individuals without this background. Often such bequests are very large. Some range into the hundreds of millions of dollars.

Hence, reinstatement of this deduction will generate benefits to charitable enterprises -- and the public -- far greater than any estimate of its effect over the next several years can suggest.

A recent report by The Foundation Center illustrates the classes of charitable activity we can expect these enlarged foundation funds to support:[5]

1992 Grants of Largest Foundations

Subject	Amount	Percent
Education	$1,346,910,000	25.4
Health	943,836,000	17.8
Human Services	847,256,000	16.0
Arts and Culture	674,525,000	12.7
Public/Society Benefit*	590,217,000	11.1
Environment and Animals	255,130,000	4.8
Science and Technology	214,697,000	4.0
International Affairs, Development and Peace	178,956,000	3.4
Social Science	142,901,000	2.7
Religion	114,546,000	2.2
Other	2,740,000	0.1
TOTAL	$5,311,715,000	100.0

[*Includes civil rights, community development and volunteerism]

5 The Center's report is based on data for 1992 (the latest year available) resulting from a survey of grantmaking by foundations representing 52 percent of all grant dollars.

4 -- IRS and Treasury Have Reported No Problems or Evidence of Abuse

From time to time Congress has expressed concern about the potential overvaluation of gifts to charity. It is important to emphasize to this Subcommittee that the charitable deduction under consideration here permits full value deductions ONLY for gifts of publicly traded stock. Other types of appreciated property which may be more open to overstatement are simply not included. Gifts of land, privately held stock, partnership interests, works of art and even bonds are not included. In short, a donor to a private foundation can make use of this provision only by giving away appreciated property for which there is a recognized value published in the newspaper on the day of the gift. Overvaluation is simply not possible.

More generally, over the past 25 years, private foundations have established an admirable track record of compliance with the stringent anti-abuse rules imposed on them by the 1969 Act. Yes, there are occasional abuses, as there are in any sector, but the Internal Revenue Service -- on the basis of three nationwide audits -- has found that private foundations are among the most conscientiously compliant groups under its jurisdiction.

The core reforms enacted in 1969 for private foundations have worked well to keep out those who would abuse the system. The Council on Foundations has consistently supported the basic structure of this stricter system of regulation.

#5 -- Restoring the Deduction Will Accelerate Charitable Benefits and Produce More Effective New Foundations

Even if this charitable deduction is not reinstated in the income tax law, some individuals will doubtless create foundations by bequests at death. That was the experience even during the 1970s. With bequests to foundations fully deductible for estate tax purposes -- as they have been ever since the advent of the estate tax -- that pattern of giving would naturally recur.

Waiting to give by bequest, however, is a pattern far less advantageous for charity than lifetime giving. It deprives charitable endeavors of the use they could have made of the resources during the lives of the donors. Experience shows that, with the income tax deduction in effect, many private foundations are created during the donor's 40s, 50s and 60s. When those gifts are postponed to the donor's death, many years of foundation distribution are altogether lost to charity. One can be speculative about the magnitude of the loss, but it must at least be very considerable.

A separate point underscores the desirability of encouraging lifetime contributions. It has also been our experience in working with new foundations that they succeed with far fewer missteps if they begin operations during the life of the donor and can be guided by him or her while they are growing, learning and developing experience with philanthropy. Again and again, as we work closely with family foundations, we see that donors who get personally involved in their foundations during their lives tend to involve their families and begin family traditions of ongoing charitable commitment and wise giving. More effective foundations and more altruistic family traditions result.

In sum then, restoring the charitable deduction for gifts of publicly traded stock to private foundations presents a rare opportunity to transform substantial wealth now held for personal purposes to a major resource permanently dedicated to the support of sound and creative charitable works.

For these reasons, I strongly urge you to renew this deduction and make it a permanent part of the Internal Revenue Code.

ABOUT FOUNDATIONS

What is a Foundation?

Foundations are nonprofit organizations that suppport charitable activities in order to serve the common good. They provide this support by making grants to other nonprofit agencies, or through operating their own programs. In some cases, such as scholarships and disaster relief, foundations may make grants to individuals. Education, public health, scientific research, the arts, social services, religious organizations and the environment are just a few of the areas in which foundations provide funding

Foundations are created with endowments--money given by individuals, families or corporations. They make grants or operate programs with the income earned from investing the endowments. While foundations are exempt from federal income tax, they pay an "excise tax" on their net investment income each year.

The Tax Code distinguishes between private grantmaking foundations, which generally make grants from endowment income, and public charities, which generally raise money from the public for various causes and then operate institutions or programs such as universities or hospitals. Both foundations and public charities may use the term "foundation" in their titles, but very different laws apply to the organizations.

Why are Foundations Unique -- What do They do Best?

The governing boards of foundations are not subject to public elections nor (in most cases) are they subject to the concerns of corporate shareholders. Since most foundations have permanent endowments, they do not need to raise funds each year from the public in order to continue their work. Freed from these constraints, foundations are perfectly positioned to act as the research and development arm of society.

In its 1965 Report on Private Foundations, the Treasury Department recognized the special nature of foundations by describing them as "uniquely qualified to initiate thought and action, experiment with new and untried ventures, dissent from prevailing attitudes, and act quickly and flexibly." Foundations reflect the innovative spirit of the individuals and corporations that endow them. They provide risk capital for new approaches to tackling social problems and can make long-term commitments to addressing community needs. To list just a few examples of their impact, private foundations were the impetus behind the development of the Salk polio vaccine, the beginnings of the Head Start program and the production of *Sesame Street*.

How Many Foundations are There?

According to the 1994 edition of *Foundation Giving*, published by The Foundation Center, there are over 35,000 private, community, operating and corporate foundations in the United States:

- 31,604 private independent foundations
- 1,897 private corporate foundations
- 353 community foundations
- 1,911 operating foundations

At least 75 percent of all foundations are small and unstaffed; they are run either by volunteer boards or professionals (bank trust officers or lawyers). There are fewer than 6,800 foundations that have more than $2 million in assets or make over $200,000 in grants, yet these foundations hold 91% of foundation assets and are responsible for 90% of all foundation grant dollars disbursed. Of these larger foundations, roughly one in four have paid staff.

How Much do Foundations Give Each Year?

Together, grantmaking foundations held over $175 billion in endowment assets and made grants totaling approximately $10 billion to charitable causes in 1992. Yet, this annual grant amount is only eight percent of the $124.3 billion that Americans contributed to charity in the same year. According to *Giving USA 1994*, published by the American Association of Fundraising Counsel, total private philanthropic giving in 1992 was (in billions of dollars):

--	Individuals	$ 99.18	81.4%
--	Bequests	8.15	6.7%
--	Independent & Community Foundations	8.64	7.1%
--	Corporate Foundations	1.60	1.3%
--	Direct Corporate Giving	4.32	4.8%
		$121.89	100%

What is the Capacity of Foundation Giving?

In virtually every significant area, foundations lack the resources to replace most government programs and, as noted below, the focus of foundations' grantmaking is often legally limited or directed by the donor. Total foundation grantmaking for 1992 is approximately equal to:

1) The annual budget for the National Institutes of Health
2) 20 percent of the amount (almost $53 billion) that the government spent on education, training, employment and social services in 1993,[1] and
3) Less than 10 percent of the $125 billion in government spending on Aid to Families with Dependent Children, food stamps and Medicaid.[2]

What Limits are there on Grantmaking Focus?

Governing boards of some foundations have broad discretion regarding the charitable causes to which foundation grants may be directed; other boards are sharply limited -- often legally -- by the mandate of the foundation donor. For example, some foundations are restricted to making grants only for medical research, for assisting artists or for scholarships. Many foundations must restrict their grantmaking to a specific geographic area.

Where Do Foundation Grant Dollars Go?

According to *Foundation Giving*, in 1992, foundation grant dollars were distributed as follows:

	% of Grant Dollars	% of Grants
Education	25	23
Health	18	13
Human Services	16	21
Art & Culture	13	15
Public/Society Benefit*	11	12
Environment & Animals	5	5
Science & Technology	4	3
International Affairs	3	3
Social Science	3	2
Religion	2	2
TOTAL	100%	100%

* "Public/Society Benefit" grants include those for community development, public affairs, civil rights, social action and voluntarism.

How Does Giving by Foundations Differ from United Way Campaigns and Direct Giving by Individuals?

Private, community and many corporate foundations have endowments and thus are free from the uncertainties, struggles and costs of annual fundraising campaigns. By prudently managing their investments, they are able to provide a steady source of funding from the income and growth of the endowments while striving to keep the value of the endowment even with inflation. Thus, when economic downturns reduce individual giving, foundations are often able to maintain their grant levels.

How Do Foundations Work with Government?

In addition to making occasional grants to government, several foundations have taken steps to collaborate with Federal, state and local governments to streamline service delivery and explore cost-effective alternatives to traditional social services. Foundations have provided a source of non-partisan expertise and a perspective that extends beyond one administration's time in office. Foundations stimulate institutional reform through studies and support governmental change by funding model projects that have the potential for replication.

For More Information

Legislative affairs contact: John Edie or Anne Babcock, Council on Foundations, 202/466-6512
Programs and policy contact: Lauren Cook, Council on Foundations, 202/466-6512
Media contact: Mary Braxton or Greg Barnard, Council on Foundations, 202/466-6512

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[1] U.S. Government Printing Office, **Budget of the United States Government Fiscal Year 1995 (1994)** 253.

[2] Pear, *Welfare Debate Will Re-examine Core Assumptions*, N.Y. Times, Jan. 2, 1995.

PHILANTHROPY'S GREAT GRANTS

The developments described here have touched the lives of nearly every American--and yet not many Americans would readily make the connection that foundation grants helped make them happen. Because foundations serve as society's research and development arm--by funding programs that explore new problem-solving approaches--much of value is learned from those foundation-funded experiments that don't work out as well as the wide-impact successes described here.

White Lines on the Highway

In the early 1950s, engineer-inventor Dr. John V. N. Dorr had come up with a "revolutionary highway theory." He postulated that at night and when it was rainy, snowy or foggy, drivers hugged the white lines painted in the middle of highways. Dorr believed this led to numerous accidents and that painting a white line along the outside shoulders of the highways would save lives.

Dorr convinced highway engineers in Westchester County, New York, to test his theory along a stretch of highway with curves and gradients. The decrease in accidents was dramatic, and a follow-up test in Connecticut had similar results. Dorr then used his own foundation, The Dorr Foundation of New York, to publicize the demonstration's results.

Although state funds are now used to paint white lines on the shoulders of this nation's highways, every person who travels in a motor vehicle is indebted to Dorr and his foundation for the implementation of this life-saving discovery.

Emergency 911

Dial "911" any time of day or night from any telephone in the United States, and an operator will spring into action to determine the type and location of the emergency, send appropriate personnel and equipment to the scene, and tell you what to do until help arrives. It is such an important safety net that 911 is often one of the first phone numbers parents teach their children.

Efforts to create a national emergency medical response system began in 1966, when the National Highway Safety Act authorized funds for ambulances, communications and training programs. These efforts were augmented in the early 1970s when the Robert Wood Johnson Foundation provided 44 grants in 32 states for regional emergency medical services--the largest sum of private funds ever allocated for this purpose. The foundation program demonstrated the concept of a regionalized, systematic approach. Following these grants the federal government stepped in and made a series of grants that resulted in today's nationwide 911 system.

The Pap Smear

Cervical cancer is one of the easiest cancers to treat, when caught early. Until the 1940s, however, there was no simple, inexpensive test for diagnosing this disease. During the 1940s, however, there was no simple, inexpensive test for diagnosing this disease.

Dr. George N. Papanicolaou first discovered that cervical cancer could be diagnosed, before a women presented any symptoms, in 1923. Although he reported his findings, pathologists dismissed them, unwilling to believe cancer could be detected in individual cells. Dr. Papanicoulaou later wrote, "I found myself totally deprived of funds for continuation of my research...At a moment when every hope had almost vanished, The Commonwealth Fund...stepped in." Support for Dr. Papanicolaou's highly speculative work proved crucial to the development and eventual acceptance of the Pap Smear--the basic and now routine diagnostic technique for detecting cervical cancer.

Invention of Rocketry

The development of rocket science was a necessary precursor to space exploration, of strategic importance to America, as well as satellite communications, which touches our lives today in innumerable ways. It was foundation money that permitted a scientist to develop the technology that helped this nation become the first to place a man on the moon.

After having built a rocket that could travel in a vacuum, physics professor Robert H. Goddard received a small grant from the Hodgkins Fund of the Smithsonian Institute to build a high-altitude version of it. He succeeded in 1926, when he launched a rocket that flew 41 feet in the air for 2.5 seconds. A subsequent launch caught the attention of neighbors, police and reporters--who considered his efforts a joke--and Harry Guggenheim. Guggenheim consulted with Charles Lindbergh on the feasibility of Goddard's ideas, and it was Lindbergh who persuaded Guggenheim's father, Daniel Guggenheim, to provide four-year's support for Goddard's work. Ultimately, the Daniel and Florence Guggenheim Foundation funded Goddard's work for 11 years.

"Sesame Street"

Every day, 75 percent of this nation's preschool children learn their ABCs, colors and numbers from a huge yellow bird, a frog, a garbage-can "grouch," and a host of brightly colored puppets--along with a few human actors--on "Sesame Street." The children who tune in have fun while learning the basic cognitive and social skills they need to make the transition from home to school. In an average week the show reaches 16 million viewers; it is the most widely viewed children's series in the world.

Although "Sesame Street" is self-supporting today, this was not always the case. During the early 1960s the National Education Association endorsed the idea of making preschool

Yellow Fever Vaccine

By the beginning of this century Boston and Baltimore had experienced a total of 50 yellow fever epidemics and Charleston, South Carolina; Galveston, Texas; the Mississippi Valley and New Orleans, Louisiana had lost tens of thousands of people to the illness. Victims were being buried day and night.

Beginning in 1915, the Rockefeller Foundation funded a 30-year, all-out effort to eradicate this disease. Foundation physicians and scientists travelled to the cities and jungles of South America and West Africa, where they set up on-site laboratories and investigated causes of the disease. Many Rockefeller researchers died of the fever during the course of their work, but in 1936, foundation efforts paid off with the development of the first successful yellow fever vaccine. More than 1 million people were vaccinated in 1938 (with a 90 percent success rate) and during World War II, more than 34 million doses were manufactured and distributed free to Allied governments and health agencies. In 1951, foundation scientist Dr. Max Theiler received the Nobel prize in medicine for his work on the yellow fever vaccine.

Polio Vaccine

It was only 40 years ago people that in this country and the world lived in fear of the deadly, crippling effects of polio. Just recently, in December 1994, the Pan American Health Organization announced that polio finally has been eradicated from the Western Hemisphere. The visions of people in iron lungs and heavy braces have been all but erased from this nation's memory because of the Salk vaccine developed by Dr. Jonas Salk in 1953.

Salk was able to establish and equip his virus laboratory, located at the University of Pittsburgh, because of a 1948 grant from the Sarah Scaife Foundation (later known as the Sarah Mellon Scaife Foundation). Other foundations also supported Salk's work, but it was the Scaife foundation that put up the initial risk capital and provided a followup grant two years later.

Public Libraries

Going to the local library and borrowing books for free is a privilege most Americans take for granted. Yet less than a century ago the idea of equal access to books and educational materials was revolutionary and controversial. It was the generosity and vision of one man, Andrew Carnegie, that created more than 2,500 libraries worldwide during the early 1900s.

Nearly every community that requested support from Carnegie or his foundation--Carnegie Corporation of New York--received it, and by the 1920s funds from Carnegie and his foundation had led to the construction of 1,679 public libraries in the United States alone. Today, these libraries, each a monument to the grand architectural style of the time, are an integral part of this nation's public library network.

education available to all children, but funds available within school budgets were not sufficient for such programs. In 1966, Carnegie Corporation of New York underwrote a feasibility study on the use of television for preschool education. Carnegie, along with the Ford and John R. and Mary Markle foundations and others then gave Children's Television Workshop grants to launch "Sesame Street."

The Hospice Movement

In the early 1970s, long-term care for the terminally ill was a frustrating and saddening experience for families. A group led by Florence Wald, dean of the nursing school of the Yale-New Haven Medical Center, asked foundations to fund a feasibility study on opening a hospice in New Haven, Connecticut.

Simultaneous support from the Van Ameringen Foundation, the Ittleson Family Fund and The Commonwealth Foundation assisted in establishing and staffing a hospice to care for 100 terminally ill patients in their homes as well as a 44-bed facility. This program became a model for hospital and home care of terminally ill patients and a training center for hospice workers.

World Hunger

In the 1960s, the threat of widespread starvation in developing nations was one of the most pressing issues facing world leaders. Developing nations lacked the resources for the large-scale food production required to feed their expanding populations. A collaboration betwen the Ford and Rockefeller foundations created research centers, which brought together scientists from around from around the world to develop improved varieties of wheat and rice.

Two centers, the International Rice Research Institute in the Philippines and the International Maize and Wheat Improvement Center in Mexico created new varieties of rice and wheat that greatly enhance yields. The results were astounding--where just a short time before experts had predicted famine, countries quickly became self-sufficient, providing food at a low cost. Called the Green Revolution, this effort to improve agricultural practices also led to more jobs and goods for trade.

Mr. HERGER. Thank you very much, Mr. Joseph.
Mr. Thompson.

STATEMENT OF JESSE J. THOMPSON, FOUNDER, PROVIDENT BENEVOLENT FOUNDATION, CHARLOTTE, NORTH CAROLINA; ACCOMPANIED BY ROBERT S. MARQUIS, KNOXVILLE, TENNESSEE

Mr. THOMPSON. Mr. Chairman, my name is Jesse J. Thompson. I live in Charlotte, North Carolina. I appreciate the opportunity to appear before you and the other Subcommittee Members.

I am very much concerned with the question of reenactment of section 170(e)(5) of the IRC. Both my family and I believe strongly in gifts to charity through private foundations. It is my hope that by sharing with you some of my experiences with private foundations, we can show some of the good which they can accomplish.

My family made its living in the coal industry and we were very fortunate. Through a combination of hard work and good luck, we built a successful business that employed hundreds of workers. We have not, however, ever forgotten where we came from.

As a family, we now wish to share our good fortune with people in the areas where our family built our business. We feel strongly that we have been blessed and we wish to share our blessings with the communities and the people in the communities who helped us. Through our private foundations, we hope to be able to give something back to the communities and the people in Tennessee, Kentucky and Virginia who made our success possible.

Shortly before his death in 1987, my father established the Thompson Charitable Foundation, a private foundation which, when completely funded, will hold assets in excess of $70 million. Since its inception, the Thompson Charitable Foundation has distributed millions of dollars to charities and public works in our region.

I would like to focus on three projects which I believe illustrate the contributions which private foundations can make to the public good.

Buchanan County, Virginia, is located in the heart of the coal country. The people of Buchanan County have relied upon wells for their water supply for generations. Not surprisingly, the quality of the water has been quite low. In 1991, with the aid of a $1 million contribution from the Thompson Charitable Foundation and a Federal grant, Buchanan County built a modern water supply connected to the John Flannagan Dam Reservoir. Most Americans take issues like their water supply for granted. Now the citizens of Buchanan County also can have that luxury.

Scott County, Tennessee, is a coal mining community located in Tennessee's Cumberland Mountains. Like many rural communities, its needs are generally underfunded and ignored because it lacks the political clout of larger more urban counties. With an average annual income of less than $12,000 per year, the people of Scott County must struggle to meet the needs of the community.

The problem manifested itself in Scott County's school buildings, which had deteriorated to the point where it was difficult for the children to get a good education. The Thompson Charitable Foun-

dation provided approximately $1 million of the funding needed to build and equip new schools.

The entire community gathered in support of this project and the partnership has proven to be an overwhelming success. Scott County now boasts a new elementary school and its high school and middle schools have been rebuilt and equipped with state-of-the-art equipment. The long-term results have been even more rewarding. These schools recently won the Governor's Award, which recognize the national level achievement of Scott County's students.

My father lost his wife and several friends to cancer. As a result of his personal experience, he became acutely aware of the strain placed on families who were required to travel across the country in order to get the specialized care that cancer treatment so often requires. His concern led to the establishment of the Thompson Cancer Survival Center in Knoxville, Tennessee. During the financially difficult early years of its existence, the Thompson Cancer Survival Center was dependent upon the Thompson Charitable Foundation for the funding needed for this project to which my father was so dedicated. My father ultimately died of cancer.

These are but three examples of the important work that private foundations help to make possible. There are many more. These examples not only demonstrate the type of projects to which private foundations contribute, but also show that private foundations are often the catalysts which change dreams to reality.

I have seen the positive impact that they can have, and I have created my own private foundation, the Provident Benevolent Foundation, in Charlotte, North Carolina. Unfortunately, I have not yet fully funded it. I want to continue funding it. In fact, I have been doing so with appreciated stock. Now that section 170(e)(5) is no longer in effect, as a practical matter, I am penalized for contributing to Provident Benevolent, rather than public charities.

Of course, you might say I still have the ability to give directly to public charities. Many worthwhile projects will find their way to a private foundation which public charities are not interested in. Private foundations have played an important role in the charitable giving network. They can continue to do so. In this time of concern with controlling government spending, both public and private foundations are instruments for help.

I invite you to visit the Thompson Charitable Foundation and the Provident Benevolent Foundation and see for yourself the good works in which they have participated. I urge you to reinstate section 170(e)(5) so that private foundations can continue to grow and to help individuals and communities in need.

Mr. Chairman, sitting directly behind me is Robert S. Marquis from Knoxville, Tennessee. He has been our family's attorney for 20 years. He is a tax attorney and he has helped several individuals set up foundations. He has with him today a statement supporting the reenactment of section 170(e)(5) and, with your permission, I would like to ask that his statement be submitted for the record.

Mr. HERGER. Without objection, so ordered.

Mr. THOMPSON. Thank you very much.

[The prepared statement follows:]

STATEMENT OF ROBERT S. MARQUIS

Attorney and Principal
McCampbell & Young, P.C.

**STATEMENT OF ROBERT S. MARQUIS
BEFORE THE SUBCOMMITTEE ON OVERSIGHT,
COMMITTEE ON HOUSE WAYS AND MEANS,
U.S. HOUSE OF REPRESENTATIVES,
on May 9, 1995**

Madam Chairman:

My name is Robert S. Marquis and I am an attorney practicing in Knoxville, Tennessee. I appreciate the opportunity to appear before you and the other SubCommittee Members. I am here to encourage you to reinstate § 170(e)(5) of the Internal Revenue Code, and to share with you my real world experience concerning its importance. The only evidence I intend to offer is based on my own personal experiences which I believe support my position.

As an attorney working in Knoxville, Tennessee, since 1973, my practice is devoted primarily to estate planning. As is common among practitioners in this area, I have worked extensively with charitable organizations, serving both as counsel and as a director of several private and public foundations. I am here on behalf of certain of my clients who have specifically requested me to testify before you concerning the reinstatement of § 170(e)(5). But I am also here in my capacity as both a member of the estate planning bar and as a concerned citizen. Without exception, both the clients and other practitioners with whom I have spoken share my concern regarding the singular importance of this statute to charitable giving in general and to charitable activities in our community in particular.

Greater Knoxville has a population of approximately 500,000. In our area, I have participated in the establishment of approximately a dozen private charitable foundations and have worked with several others. I think it important for you to understand how and why these private charitable foundations came to be created and how, at least in my experience, they are operated.

There is no precise demographic profile of the donor who desires to establish a private charitable foundation -- indeed, I once had a retired school teacher who wanted simply to establish a private foundation to finance the needs of underprivileged band members -- but I would have to say that most of the donors which whom I work are wealthy. Most have achieved high levels of success and the wealth which so often accompanies it. They recognize and appreciate their good fortune, and desire simply to give something back to the community and the people who provided them with the opportunity to succeed.

Private foundations usually bear a strong resemblance to their founders. Such individuals typically possess a strong work ethic and a fierce determination to accomplish their goals.

Thus, just as small businesses are often more responsive to the needs of the market, so too are private foundations often more attentive and more responsive to the needs of the communities they serve. As a result, the cost-effectiveness of private foundations is unique.

Since we live an era where public funds have grown increasingly scarce, and the resistance to tax increases is almost universal, the competition for these funds is fierce. Add to this mix the very real concern we all share with respect to both budget deficits and the national debt, and the need for, and importance of, charitable giving is readily apparent. Irrespective of the provisions of the Internal Revenue Code, some level of charitable giving will always take place. Nevertheless, we all recognize that the Internal Revenue Code creates a powerful incentive for Americans to increase their charitable giving. Conversely, common sense tells us, and my experience confirms, the expiration of § 170(e)(5) has created an equally powerful disincentive to their charitable giving.

To be blunt about it, private foundations have been eliminated as a lifetime planning option for many of our clients. While the economic issue here is fairly obvious, the psychological issue is not. I have observed first hand the special relationship which founders have with their private charitable foundations. That is, private foundations allow their donors to become actively involved in the charitable works to which their foundations contribute. This frequently stimulates the founder's desire to give even more to the foundation.

Remember also that the worthy causes to which we are all asked to contribute seem endless. Who among us hasn't invoked the defense "I gave at the office?" But the pool of wealthy donors is limited. Private foundations occasionally have returned the joy to charitable giving to our clients by providing both donor and donee with a common forum. There is a very real efficiency gain to be found here which should not be underestimated.

Finally, private foundations are required by the federal tax code to make distributions each year and public charities always reap the benefits. Our clients understand this, and now ask why we discriminate against private foundations. The answer escapes me. And let us not forget that a contribution to a private foundation is irrevocable; the charitable giving which the annual distributions of private foundations represent is not subject to an individual's change of mind.

These are practical realities. I know from my own experience that private foundations work, and that the ultimate beneficiaries of the reinstatement §170(e)(5)will be the communities they serve. And in a world of limited public resources, can we afford to discourage charitable giving?

Thank you for the opportunity to appear before you today.

Respectfully submitted,

Robert S. Marquis

Mr. HERGER. Thank you very much, Mr. Thompson. We certainly appreciate more than we can express the generosity of yourself, your father and your family. Certainly, that type of caring is the backbone of our country, and what a great example you are. Again, thank you.

Mr. THOMPSON. Thank you.

Mr. HERGER. With that, we will move to our last panelist, Mr. Licata.

STATEMENT OF JOSEPH A. LICATA, VICE PRESIDENT, EMPLOYEE BENEFITS, SALOMON BROTHERS, INC., NEW YORK; NEW YORK, ON BEHALF OF AMERICAN PREPAID LEGAL SERVICES INSTITUTE, NATIONAL RESOURCE CENTER FOR CONSUMERS OF LEGAL SERVICES, HOTEL TRADE ASSOCIATION OF NEW YORK, HOTEL TRADES COUNCIL, AFL–CIO PREPAID LEGAL FUND, AND LABORERS INTERNATIONAL UNION; ACCOMPANIED BY GERALD MANN, ADMINISTRATOR AND CHIEF COUNSEL, DISTRICT COUNCIL 37 MUNICIPAL EMPLOYEES LEGAL SERVICES PLAN, NEW YORK, NEW YORK

Mr. LICATA. Thank you, Mr. Chairman.

My name is Joseph Licata. I am vice president of employee benefits for Salomon Brothers, Inc. With me here today is Mr. Gerald Mann, administrator and chief counsel of District Council 37 Municipal Employees Legal Services Plan. His testimony is also submitted on behalf of the American Prepaid Legal Services Institutes, the National Resource Center for Consumers of Legal Services, the Hotel Trade Association of New York, and the Hotel Trades Council AFL–CIO Prepaid Legal Fund, and the Laborers International Union.

On behalf of the 7.6 million Americans who access employer provided legal services plans, I would like to thank you for the opportunity to submit testimony in support of restoring equity to this employer provided benefit by reinstating its favorable tax treatment.

While my employer Salomon Brothers may not immediately evoke thoughts of moderate income working families, in fact, over two-thirds of our employees or approximately 3,600 workers are middle-class workers of moderate means, for example, our clerks, support staff, secretaries, telephone operators and courier staff, to name a few. Virtually all of the employees who are enrolled in our legal benefits plan, over 600 in number are wage earners in the low- to middle-income salary range. As with AT&T, Raft, Proctor & Gamble, Sears and many other corporations, it is on behalf of these important members of our team that we urge Congress to restore equity to the tax treatment of this benefit.

The firms management at Salomon Brothers, while generally not electing to participate in our legal benefits plan, is satisfied with providing this benefit for the staff because it contributes to the well-being of these critical members of the firm and thus increases our firm's productivity as a whole. In limiting the stress associated with legal issues by allowing these employees access to legal advice, this benefit provides tremendous value to our work force.

We strongly support H.R. 540 introduced by Representative Charles Rangel to make permanent section 120 of the IRC, thereby restoring equity to the treatment of this employment benefit.

In light of the fact that this employment benefit is provided to and for working middle-class Americans, allowing for its favorable tax treatment coalesces well with the national clamor for middle-class tax relief.

Specifically, in terms of middle-class tax relief, reinstating the favorable tax treatment of this particular employee benefit provides tremendous value to the taxpayer for the cost, because it allows low- and moderate-income wage earners access to legal advice which they would not otherwise be able to afford.

Having access to legal advice represents to a moderate-income wage earner the difference between a swift favorable resolution of a problem and a stressful long-term morass with an unfavorable outcome. Tax relief that could provide such an enormous benefit to working families, a benefit to families' security, stability and financial situation, constitutes the highest possible rate of return on taxpayer investment.

Employer-provided group legal plans have time and again proven their value in extending low-cost legal advice to working Americans. The reality for middle-class wage earners is that they cannot afford the services of an attorney and thus cannot afford to obtain advice for issues relating to child support enforcement, adoptions, wills, landlord-tenant situations and consumer debt problems.

Employers are pleased to provide this important benefit, because it removes troubling legal distractions from their employees which, left unattended, limit the employees' productivity. As a result, legal benefits plans enjoy broad support from corporate, consumer, labor and insurance groups. Because it provides access to legal advice, this employer-provided benefit assists working Americans in avoiding the family disintegration and job disruption that can result from neglected legal issues.

Examples of the multilevel cost effectiveness of this benefit abound. A working mother seeking to enforce an order of child support gains access to the assistance of a lawyer through this legal benefits plan and avoids the need to rely on public assistance. A consumer debt problem without legal advice can lead to a garnished salary, an eviction, the loss of a job, and dependency on public assistance.

The relatively minor cost of providing this favorable tax treatment is repaid innumerable times by keeping the wage-earner focused on his/her job, keeping a family in housing and intact, and removing the threat to moderate-income workers to remaining self-sufficient. In the last two renewals of the legal plan at Salomon Brothers, the cost of our premiums has not increased for my firm.

Employer-provided legal benefit packages produce economies in both the purchase of legal services for a large group and in the delivery of these services at a reduced price. Such economies in the provision of legal representation for the needs of average working Americans dovetails well with other types of legal reform this Congress has adopted in the last few months. Because they provide a cost-effective approach, these employer-sponsored legal benefit

plans are in the best American tradition of pragmatic, voluntary group action to meet common needs.

In the last session of Congress, this bill enjoyed broad support among both Republicans and Democrats, with 220 Members signing on as cosponsors. Already this session, this bill has 31 cosponsors and a "dear colleague" letter has yet to be circulated. Speaker Gingrich himself was among the cosponsors of this bill last session and has voiced support of the bill again this session.

In summary, we would highlight that, without this benefit, low- and moderate-income wage earners would not have access to legal advice from the private bar, the consequences of which are severe impediments to the self-sufficiency of these working families. Restoring equity to the tax treatment of this benefit by placing it on an equal footing with other statutory fringe benefits is a goal worth achieving this session, given that this employer-paid benefit provides so many concomitant valuable advantages to working Americans.

As one aspect of middle-class tax relief, a high return on the cost of this benefit is realized for the millions of working Americans who gain access to critical legal advice through its operation. By promoting economies in the purchase and delivery of legal advice, this benefit constitutes an important facet of legal reform.

We respectfully urge the Subcommittee to act favorably on H.R. 540. Thank you, Mr. Chairman, for letting me speak on this issue.

Mr. HERGER. Thank you for your testimony, Mr. Licata.

Mr. Young, it has been argued that H2–A workers are less expensive to employ than U.S. workers. Your testimony is responsive to this question, do wages paid to H2–A workers count against the FUTA wage threshold, and just what does this mean?

Mr. YOUNG. Yes, Mr. Chairman. My statement was that the wages paid to H2–A workers are higher than wages paid to the average U.S. farm worker and that the program is not an expensive one. We are not using the minimum wage, but we are using what is called an adverse effect wage rate, which is substantially higher. In the case of New York and New England, it is based at $6.21 an hour in 1995.

But the wages of H2–A workers prior to the exemption expiring were counted in the base number. They counted toward reaching the threshold that are necessary, but they were not taxed.

Mr. HERGER. Thank you.

Mr. Ashworth, do H2–A workers tend to work for the largest or the smaller agricultural employers?

Mr. ASHWORTH. I think that it would probably be more the smaller farms, but not excluding large farms. In my experience of working H2–A workers, being a small farmer myself, it was a godsend to have this type of labor, and smaller farms I think probably benefit as much or more than the larger farms.

Mr. HERGER. Why is their a need for this?

Mr. ASHWORTH. The H2–A worker is not eligible for Federal unemployment, so it would not be fair to pay a premium or a tax per se on something that could not be collected. Being that when this job is over, the H2–A worker comes under contract, and when this job is completed, this person will return to their original home in their own country.

Mr. HERGER. In the past, the rationale for the FUTA tax exemption for H2–A workers is that this group does not collect unemployment benefits. To your knowledge, has there been any change in the status or treatment of these temporary agricultural workers that would suggest employers should now begin paying FUTA taxes?

Mr. ASHWORTH. I know of no change that would create a need for employers to pay this tax. The exemption expired at the end of 1994, and what we would ask is for it to be retroactive to January 1, 1995 permanently.

Mr. HERGER. Are there any other categories of labor upon which employers are required to pay FUTA employment taxes? Where the employees are not permitted to draw the benefits or the laborers are permitted to draw the benefits?

Mr. ASHWORTH. I am not aware of any.

Mr. HERGER. Thank you.

Ms. Raines, while all of us would agree that it makes sense to encourage the development of orphan drugs, there is a tension between the need to provide a credit that is meaningful and the need to minimize the cost to the Treasury. It is difficult to know whether a 50-percent credit strikes the appropriate balance. What would the level of the credit be to encourage the development of needed drugs without an undue loss to the Treasury under your estimation?

Ms. RAINES. Let me say first that the 50-percent credit which has been in effect for the last 12 years has had a significant impact in increasing the number of orphan drugs in development. Clearly, a bigger credit would encourage more and a smaller credit would encourage less. I think that people in business take that into account when calculating what is the anticipated cost of developing a product.

What you are going to do if you reduce the credit is reduce the likelihood of development of those products that are most marginal in terms of the potential of returning the investment that is made. Recognize, too, that these are very high risk investments, that 9 out of 10 drugs do not work and do not make it to the marketplace. Under those circumstances, the market dictates that you go after the drugs that are likely to make it to the marketplace, and that have big markets out there waiting for them. Clearly, you can ratchet the tax credit up or down and anticipate the effects to be different.

The cost of this credit is lower than the cost of any other credit that this Committee has had under discussion today. The Joint Tax estimate is under $170 million over 5 years, and that includes the changes that would make the credit more valuable and more of an incentive for smaller companies, not by changing the percentage, but by allowing the credit to be carried forward to the future.

Mr. HERGER. If Congress were to allow this credit to expire, what do you feel the result would be?

Ms. RAINES. Already, companies have said that uncertainty about the orphan drug law itself and the credit has discouraged them from developing products for those markets. I am aware of several companies that probably prefer not to be named publicly who are no longer doing orphan drug research.

We have made a commitment to orphan drug research in a number of areas where it just makes sense, regardless of the credit, for us to continue. Whether we will start new programs in the absence of the credit is another question.

Mr. HERGER. Particularly with those drugs with little usage. The drugs that were for special needs would particularly be hard hit. Even though the drugs may be very effective, because there would not be much of a sale for them, they would have a difficult time.

Ms. RAINES. That is absolutely correct.

Mr. HERGER. Thank you very much.

Mr. Joseph, I have a couple of questions for you, if I could. What percentage would you estimate of gifts to private foundations are made in the form of publicly traded stock? Would you have any estimate of that?

Mr. JOSEPH. Mr. Chairman, there is no quantitative data available, but if you look at the period in which this provision was in effect, during that period we averaged about 256 new foundations a year for that decade. In the decade before we only had 79. The only quantitative data is from the State of Michigan who reported that there were 52 foundations in the last 6 years formed with appreciated stock in the State of Michigan.

Mr. HERGER. I am not sure if you have any data on this, but in general the stock is usually maintained or sold as part of the endowment, and, if sold, is that within a short time after receipt or over a period of time that the market need would indicate appropriate? Do you have any knowledge on this?

Mr. JOSEPH. No, we do not have any data on that. I can look at what is available and provide what I can, but it is mostly anecdotal and reports from individual lawyers, accountants, attorneys, and real estate planners who call our offices.

Mr. HERGER. Thank you very much.

I thank each of the Members of our panel for your testimony. With that, we will conclude this Subcommittee of Oversight of Ways and Means. Again, thank you very much.

The Subcommittee stands adjourned.

[Whereupon, at 4:35 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

BEFORE THE

COMMITTEE ON WAYS AND MEANS

OVERSIGHT SUBCOMMITTEE

UNITED STATES HOUSE OF REPRESENTATIVES
WASHINGTON, D.C.

HEARING DATE - MAY 9, 1995

Statement of Stephen A. Alterman
President
Air Freight Association
1220 19th Street, N.W.
Suite 400
Washington, D.C. 20036

H.R. 752 - A Bill to Repeal the Tax on Commercial Aviation Fuel

The Air Freight Association is a nationwide trade organization representing the interests of United States all-cargo airlines. Our membership includes virtually all of the country's major all-cargo carriers, as well as other companies and individuals with a stake in the air freight marketplace. A current Membership List is attached hereto. On behalf of our membership, we urge that H.R. 752, a Bill to repeal the tax on commercial aviation fuel, be enacted by the Congress of the United States. In support of this position, the Association states as follows:

At the present time, the airline industry is exempt from the 4.3 cent per gallon tax on aviation fuel. This exemption was based on a recognition that the United States airline industry generally has been experiencing difficult financial times and that a 4.3 cent fuel tax increase would only exacerbate these problems. However, by its terms, the exemption expires on September 30, 1995 (26 U.S.C. 4092(b)) and the industry is again faced with a significant potential financial liability. Current estimates indicate that, as an industry, the airlines will pay more than **$527 million** annually in these new taxes alone. These fees are in addition to the **$6.5 billion** the industry and its customers already pay annually in passenger and cargo taxes.

While airline fortunes have improved somewhat in the past two years, it will literally take years to recover from the recent history of losses. Over the past four years alone, the industry has lost upwards of $13 billion. In addition, during this time period, over 100,000 airline jobs have been lost. Indeed, even in the best of times (and even for the most profitable companies), the profit margin for industry members is slim.[1] Now is not the time to reverse any gains made by imposing a new tax on the airline community.

Moreover, it should be recognized that, contrary to the assertion of some observers, the airline industry, and its users, fully pays for the services used. Both the 10% passenger ticket tax and the 6.25% cargo waybill tax raise enough money the support the private portion of the nation's aviation system. And the "public contribution" of slightly over $2 billion annually is not a subsidy, but rather payment for the use of the system by the military and public aircraft.

In short, the airline community should not be expected to pay a disproportionate share of the nation's tax burden. We do not oppose the user fee concept, but it is unfair to expect us to subsidize the rest of society. The imposition of the added 4.3 cent per gallon tax would be just such an unfair burden.

Accordingly, the Air Freight Association urges that H.R. 752 be enacted and the 4.3 cent per gallon levy be repealed. Thank you very much for the opportunity to comment on this important issue.

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[1] The Air Transport Association has stated that the industry's highest annual profit was only 2.6% of revenue (in 1988).

AIR FREIGHT ASSOCIATION MEMBERSHIP LIST

COMPANY	CITY, STATE
Air Cargo Management Group	Seattle, WA
Air Courier Conference of America (ACCA)	Washington, DC
Airborne Express	Seattle, WA
Alaska International Airport System	Anchorage, AK
American Cargo Handling Equipment	Denver, CO
American International Airways	Ypsilanti, MI
Arrow Airways, Inc.	Miami, FL
Burlington Air Express	Irvine, CA
Colography Group	Marietta, GA
Columbia Metropolitan Airport	Columbia, SC
Emery Worldwide, A CF Company	Palo Alto, CA
Express One International	Dallas, TX
Federal Express Corporation	Memphis, TN
FIDC/Fairbanks International Airport	Fairbanks, AK
Harrow & Company	New Canaan, CT
Keiser & Associates	Oakland, CA
Kitty Hawk Group	Dallas/Fort Worth, TX
The Campbell Aviation Group, Inc.	Alexandria, VA
Metropolitan Washington Airports Authority	Washington, DC
Northern Air Cargo	Anchorage, AK
Roadway Package Systems, Inc.	Pittsburgh, PA
Ryan International Airlines, Inc.	Wichita, KS
Southern Air Transport	Miami, FL
United Parcel Service	Louisville, KY
World Aviation Directory	Washington, DC

STATEMENT OF

CAPTAIN J. RANDOLPH BABBITT, PRESIDENT

AIR LINE PILOTS ASSOCIATION

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

MAY 9, 1995

THE IMPACT OF THE JET FUEL TAX ON THE AIRLINE INDUSTRY

Good morning, Madam Chairman, and members of the subcommittee, I am Captain Randolph Babbitt, president of the Air Line Pilots Association, which represents 42,000 pilots who fly for 37 airlines. I am also a former member of the National Commission to Ensure A Strong Competitive Airline Industry, which was created in 1993 by Public Law 103-13. I appreciate this opportunity to discuss with you a provision of the tax code which will have a devastating effect on our industry, namely the 4.3 cents per gallon tax on commercial aviation fuel which is scheduled to take effect on October 1 of this year.

Since 1990 alone, U.S. airlines have lost a combined total of more than $12.8 billion. While the financial suffering has been substantial, what is clearly most distressing is the toll these losses have had on the industry's employees. During this time, 120,000 U.S. airline employees and 125,000 U.S. aircraft manufacturing employees have lost their jobs. Time and time again, airlines have asked employees for relief and they have responded with pay and benefit concessions totaling in the billions of dollars. It is significant to note that at one company, employees recently gave wage and benefit concessions in excess of $4.9 billion over six years in exchange for majority ownership of the company. At other carriers, employee give-backs have averaged between 10 and 14%.

After this disastrous economic period, our airline industry is finally beginning to make a slight recovery. According to industry sources, U.S. air carriers ended 1994 with a cumulative loss for the year of $100 million, compared to the previous year's loss of $2.1 billion. Further, we were able to avoid any bankruptcies, and no significant asset sales or mergers occurred. Passenger traffic is beginning to increase, and capacity is becoming rationalized as carriers learn to live in low yield markets.

This very modest turnaround may, however, be quickly wiped out if the government is allowed to impose the 4.3 cents per gallon tax on jet fuel beginning on October 1 of this year. It is estimated that this new tax will cost the industry more than $527 million annually, and due to the elasticity of air travel demand, airlines will simply not be able to pass the tax on to the consumer. Industry analysts have in fact concluded that each 1% increase in the price of an airline ticket results in a 1% decrease in passenger traffic. We believe that imposition of this tax will not only invalidate the employee concessions I alluded to earlier but will also lead to an untold number of lost jobs, and perhaps, lost airlines.

Commercial jet fuel has never been taxed, and it never should be. The airline industry already reels under a host of taxes and user fees that are estimated at $6.5 billion annually. These include the 10% excise tax on airline tickets and a 6.25% excise tax on cargo shipments, a $6.00 International Departure Tax, a $6.50 Customs User Fee, a $6.00 Immigration User Fee, a $1.45 Agricultural Inspection Fee, and at many airports, a $3.00 Passenger Facility Charge. These are in addition to the Federal and state income, local property, and other taxes which businesses must pay. Taken together, the taxes and fees paid by the airlines are equal to a 52.5 cents per gallon

tax. In addition, in 1990, the Congress mandated that the airlines phase out the nosier "Stage 2" aircraft with quieter "Stage 3" jets by the year 2000. This will entail either replacement, re-engining, or installing hush kits on a great deal of the existing fleet. At a time when the industry is only beginning to eke out a profit after years of heavy losses, every additional operating expense distracts U.S. airlines from the costly legislative requirement to update their fleets

Nearly two years ago, the Administration and the Congress established the National Commission to Ensure a Strong Competitive Airline Industry, on which I was proud to serve. After careful and exhaustive examination of the industry's precarious financial condition, we concluded that the airlines are already over taxed and imposition of any new taxes, particularly the fuel tax, would be ill-advised. The Commission could see no good public policy reason for changing the tax treatment of airline fuel, one of the industry's two highest cost items. I strongly supported that decision then and I do now. All this tax can do is hurt--hurt airline travelers, hurt airline employees, hurt airlines, hurt airports, and therefore in the long run, hurt this country.

The Air Line Pilots Association is particularly grateful that many members of Congress have recognized that imposition of the fuel tax would be unconscionable and that legislation has been introduced in both the House and Senate to repeal it. We strongly support H.R. 752 as introduced by Rep. Mac Collins(R-GA) and S. 304 as introduced by Senator Rick Santorum (R-PA)., and urge favorable action as soon as possible. By repealing the fuel tax the Congress will demonstrate its commitment to this beleaguered industry and its employees and give them the opportunity to remain competitive in the global marketplace. Thank you for your consideration.

SUBMITTED STATEMENT OF THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS TO THE SUBCOMMITTEE ON OVERSIGHT OF THE HOUSE WAYS AND MEANS COMMITTEE ON THE SECTION 127 EXCLUSION FROM TAXABLE INCOME OF EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

MAY 9, 1995

The AFL-CIO appreciates this opportunity to provide its views on Internal Revenue Code Section 127. H.R. 127, a bill introduced by Representatives Sander Levin (D-MI) and Clay Shaw (R-FL), would make permanent the Section 127 exclusion from taxable income of employer-provided educational assistance. This bill has and deserves the AFL-CIO's strong support.

Increased investment in worker education and training is a national economic imperative. Despite that, the Congress appears close to scaling back, perhaps drastically, the federal government's already inadequate expenditures in these areas. The December 31, 1994 expiration of Section 127 will make this bad situation even worse.

Since it became law in 1978, Section 127 permitted more than seven million workers to exclude employer-provided educational assistance from their incomes for federal income tax purposes. Section 127 thereby encouraged these workers, more than 99% of whom earned less than $50,000 per year, to take courses and pursue other opportunities for education and training, and to update and improve their skills.

In unionized sectors, Section 127 also contributed to the establishment and expansion of collectively bargained educational assistance programs, one of the most important and far-reaching collective bargaining innovations of the 1980s. During that decade, an impressive array of collectively bargained programs that allow workers to upgrade their skills and further their education was put in place by unions and employers in the auto industry, the telecommunications industry, the steel industry and many others, in the service, manufacturing, public and private sectors.

Examples include the UAW-Ford Education, Development and Training Program (EDTP) which was established in 1982; similar programs involving the UAW and General Motors and the UAW and Chrysler; The Alliance for Employee Growth and Development, which was established in 1986 between the Communications Workers of America (CWA), the International Brotherhood of Electrical Workers (IBEW) and AT&T; the Enhanced Training Opportunities Program (ETOP) covering IBEW represented AT&T manufacturing workers; programs involving the CWA and AmeriTech, NYNEX, U.S. West, Bell Atlantic, Bell South and Cincinnati Bell; programs involving the IBEW and GTE, NYNEX, AmeriTech, U.S. West, United Telecom, Alltel, Allnet and the Centel Division of Sprint; the Service Employees International Union's Lifelong Education and Development Program, and its outgrowths such as the Career Ladder

Program at Cape Cod Hospital in Massachusetts; The Education Fund covering workers represented by the American Federation of State, County and Municipal Employees (AFSCME) District Council 37 employed by New York City; the Upward Mobility Program established between AFSCME District Council 31 and the State of Illinois; the Joint International Association of Machinists (IAM)/Boeing Quality Through Training Program; and the Institute for Career Development, a joint effort of the United Steelworkers of America and the major steel companies. This is just a partial list.

These programs often serve both active and displaced workers, and provide a wide range of services, such as individualized educational planning and assessment, pre-paid tuition for approved courses, and personal enhancement opportunities to brush up on reading, writing and mathematics skills. Hundreds of thousands of workers have gained access to employer-provided educational assistance as a result.

Despite these highly successful collectively bargained programs, most U.S. employers still invest far too little in the education and training of their workforce, particularly those workers who are not college graduates. When the federal government should be encouraging such investments, allowing the Section 127 exclusion to expire sends precisely the wrong message.

Without the Section 127 exclusion, many workers will not be able to afford to pursue education and training opportunities, even with employer assistance. Including contributions for Social Security and Medicare, taxes could cost workers 25% or more of their educational assistance benefit even though their cash earnings have not increased. Since 99% of the workers receiving educational assistance under Section 127 have earnings of $50,000 per year or less, and 71% have earnings of $30,000 or less, many workers who are eligible for educational assistance will no longer be able to afford to take advantage of it.

Laid-off workers, who badly need educational assistance to retrain and qualify for new jobs, will be among those who are hurt the worst. After Section 127 was scheduled to expire at the end of 1987, the UAW noted that applications from laid-off workers for educational assistance dropped at all of the major auto companies in 1988.

The Section 127 exclusion is estimated to cost a modest $300 million per year in lost tax revenues. This is a small price to pay for encouraging and enabling workers to take advantage of employer-provided educational assistance. There can be little doubt that the Treasury recoups the public's investment many times over in higher tax revenues on the increased stream of future earnings that additional worker education and training make possible.

The AFL-CIO urges the Congress to make the Section 127 exclusion permanent. Eight times since 1986, the Section 127 exclusion has been scheduled to expire. Seven times, it has been extended by the Congress, on six of those occasions retroactively. Every time Section 127 has been scheduled to expire, the resulting uncertainty has been detrimental to the utilization of employer-provided educational assistance. The time has come to recognize the important public purpose served by the Section 127 exclusion, end the counterproductive uncertainty, and make the exclusion permanent.

STATEMENT OF
THE AMERICAN FEDERATION OF TEACHERS
ON SECTION 127, THE EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE

SUBMITTED TO
THE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
FOR THE HEARING RECORD OF
MAY 9, 1995

The American Federation of Teachers appreciates the opportunity to share its views on the tax exclusion for employer-provided educational assistance. The AFT strongly supports swift action on H.R. 127, which would restore and make permanent the Section 127 exclusion for employer-paid educational benefits.

A well educated, highly skilled workforce is essential if our country is to meet the challenges of today's global economy. Since 1978, Section 127 has helped more than 7 million working Americans to attend classes in order to improve their skills and expand their economic opportunities.

The AFT's 875,000 members include teachers, classified school employees, paraprofessionals, and health care workers who have benefited from the educational opportunities made possible through Section 127. AFT locals throughout the country collectively bargain for educational benefits in their contracts, and better teachers, paraprofessionals and nurses result from the additional education they receive.

Section 127 can also play a significant role in helping our nation's school system meet its teaching needs. Current projections suggest an increasing demand for teachers through this decade and into the next century due to retirement, attrition, and a growing student population. In addition, we are already facing teacher shortages in a number of key specialty areas such as math, science, English as a second language, vocational education, computer science, foreign languages, and special education.

Many programs of teacher education and retraining which have been designed to increase the supply of teachers in shortage areas could be jeopardized in the absence of Section 127. Our teachers have participated in programs that pay for credits in special education, bilingual education, and vocational education, as well as other fields where shortages exist. The Intensive Teacher Institute offered by the State of New York, for example, currently pays for 18 credits to encourage teachers to become certified in bilingual special education.

In addition to their role in increasing the supply of teachers in critically short specialties, employer-provided educational benefits have also proved to be an important tool in attracting teaching candidates from other sources. A number of AFT locals

throughout the country have negotiated career ladders for their paraprofessionals and school aides, which help them to earn their college degrees through employer-paid educational assistance, release time, and summer stipends. More than 7,000 paraprofessionals in New York City have utilized the career ladder negotiated by their local, the United Federation of Teachers (UFT), to obtain their college degrees. Many of them have moved up in the education system, becoming teachers, guidance counselors, school secretaries, and assistant principals. Others have graduated from college and gone on to success in other fields. Over 6,000 UFT members are currently using the career ladder, and many more will enter it in the fall. In Baltimore, some 800 paraprofessionals a year are earning college credits through the career ladder negotiated by their local, and similar programs are under way in Massachusetts, Ohio, Florida, Oregon, Pennsylvania, and other sites throughout the country.

The success of these programs is particularly satisfying, since many of the participants are single parents who came to the classroom from the welfare rolls, often with no employment history and without even a high school diploma. Many of these individuals simply could not afford to take advantage of the opportunities offered through career ladders if they had to pay taxes on their educational benefits.

Restoration of Section 127 is also extremely important to health care workers represented by AFT whose contracts provide for tuition reimbursement by their employers. These educational benefits allow nurses and other health care workers to obtain Bachelor of Science degrees and to upgrade their skills and train for better jobs in a variety of critical medical specialties.

Section 127 has been highly successful in helping AFT members and other workers who wish to improve their skills and expand their economic opportunities by preparing themselves for better jobs. The AFT strongly believes that Section 127 should be restored and made a permanent part of the tax code. Since its enactment in 1978, the provision has been extended seven times, sometimes retroactively after a lapse of several months. This kind of uncertainty makes planning difficult and creates paperwork burdens for employers and employees alike. It can also discourage the participation of low-income workers who fear that they may have to pay taxes on their educational benefits.

Education is the key to increasing our economic productivity and ensuring that we can compete internationally in the 21st century. The permanent restoration of Section 127 will be a wise investment in America's workers and our nation's future.

Governmental Affairs
American
Hotel & Motel
Association

May 17, 1995

The Honorable Nancy L. Johnson
Chairwoman, Subcommittee on Oversight
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Chairwoman Johnson:

The American Hotel & Motel Association, the trade association of the lodging industry, representing in excess of 10,000 properties through a federation of state and local lodging associations, offers the following comments for the record of the Subcommittee's May 9, 1995 hearing on the Targeted Jobs Tax Credit (TJTC). As a member of the Committee for Employment Opportunities we wish to endorse the testimony of that group as presented to you by Janet M. Tully of Marriott International.

TJTC has proven to be an effective program for companies in our industry, having a positive effect on the hiring of individuals in the designated categories. The existence of a partial tax credit has helped offset higher training costs, initial lower productivity, and the extra expenditure of management time necessary to bring these employees up to levels of productivity equivalent to others in the work force. By allowing companies a method of offsetting those costs, TJTC has created a positive incentive to seek out and hire qualifying individuals.

Much has been made recently of reports and statements suggesting that many if not most individuals hired under TJTC would have been hired anyway to fill positions and that therefore TJTC is ineffective. While we do not believe this has been the case, we agree that the fundamentally changed model presented to this subcommittee will resolve that issue once and for all. TJTC exists because it was recognized that some individuals need help in breaking into the job market. TJTC provides that help by creating an incentive for employers which balances out the extra costs associated with training these individuals in the job skills needed in the work place. In addition, the new approach identifies individuals for willing employers to bring into the work force.

Despite the fact that this program has been disrupted several times by limited extensions which have been allowed to lapse and by short term renewals, it continues to be strongly supported both by business groups and individuals who are benefited by the opportunities created. TJTC should remain available on a reliable basis into the future to continue the salutary effect it has had on bringing into the work force individuals in the targeted disadvantaged categories.

We urge the Subcommittee to pass the revised version of TJTC presented to it and to do so on a permanent basis to ensure that this workable program remains available and is no longer threatened by periodic interruption.

Sincerely,

James E. Gaffigan
Vice President, Governmental Affairs

STATEMENT OF THE AMERICAN SOCIETY FOR TRAINING AND DEVELOPMENT

The American Society for Training and Development (ASTD) appreciates the opportunity to submit testimony for the record, regarding the reauthorization of Section 127 of the Internal Revenue Code, Employer-Provided Educational Assistance.

The American Society for Training and Development (ASTD), represents more than 58,000 workplace-based specialists in training, learning and performance. Members work in multinational companies, small businesses, virtual corporations, industry associations, government agencies, and colleges and universities.

ASTD's mission is to provide leadership to individuals, organizations and society in order to achieve work-related competence, performance and fulfillment.

As the pace of economic and technological change accelerates, the ability of workers and enterprises to learn and adapt becomes a core element in global competition. Success in the global economy therefore, requires companies to become high performance workplaces that integrate a skilled and educated workforce with technology, efficient systems of work organization, and continuous innovation. As a result, learning and the ability to create, extend and apply knowledge have become a critical component in the practices which result in high performance.

To build and maintain a skilled workforce, incentives are needed that encourage future training and education. For this reason, ASTD strongly supports the reauthorization of Section 127, which has been used by more than 7 million Americans workers, to pursue college or graduate-level education.

SECTION 127 BENEFITS

Section 127, which expired on December 31, 1994 allowed employers to provide up to $5250 a year in nontaxable reimbursements or direct payments to employees for non-job-related tuition, fees, and books for both undergraduate and graduate courses.

Workers have used Section 127 to improve skills and obtain better jobs. Without this tax exclusions, many workers will not be able afford courses needed to enhance their capabilities.

A 1989 study showed that nearly 99 percent of workers using the Section 127 benefit earned less than $50,000 a year, 71% earned less than $30,000 a year, and 35 percent earned less than $20,000. Taxes could cost those workers 25 percent or more of the benefit, which employers would have to withhold from their take-home pay.

Additionally, employers have used Section 127 as a valuable tool for retraining workers for other work within the company or, in the case of layoffs, for other employment in the community. The benefits have been an important way to maintain a competitive, well-trained workforce in today's global marketplace.

IMPACTS OF THE EXPIRATION OF SECTION 127

The history of Section 127 clearly points to the need for Congress to make this tax provision permanent. Prior to the enactment of Section 127, which occurred in 1978, only specifically "job related" education was excluded from gross taxable income. As a result, Congress enacted Section 127, which was designed to reduce administrative inequities arising from uncertainties often reflected in conflicting court decisions over what was and was not job-related education; reduce tax code complexity; and remove disincentives to upward mobility.

Since 1978, Congress has extended Section 127 seven times and, on six of those occasions, applied it retroactively. Although Congressional extensions have been positive, the uncertainty regarding the status of Section 127, has frequently discouraged workers and employers form using the tax exclusion. As a result, more than 1,000 workers at a major manufacturer already using Section 127, dropped out of classes when their educational assistance became taxable.

Further, the expiration of Section 127 has left only job-related training assistance exempt from an employees' gross taxable income under a separate and permanent section of the revenue code - 1.162.5.

MAKING SECTION 127 PERMANENT

Legislation (H.R. 127) that would reauthorize and make Section 127 permanent, has been introduced by Representatives Sander Levin (D-MI) and Clay Shaw (R-FL). Although ASTD recognizes that many programs may not be funded based on the current fiscal situation, ASTD strongly encourages Congress to support this bill, which would ensure that low and middle-income workers may continue to pursue lifelong learning through training and education.

CONCLUSION

Continuous education and training of the U.S. workforce is critical to meeting the challenges of the global economy. Through Section 127, employers have an opportunity to retrain workers and ensure that individuals obtain the skills needed to move into high wage jobs.

ASTD appreciates the opportunity to comment on the reauthorization of Section 127, and is supportive of the committee's efforts to examine this very important issue.

STATEMENT OF
THE AMERICAN SOCIETY OF MECHANICAL ENGINEERS
ON THE INTERNAL REVENUE CODE SECTION 127
EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE PROVISIONS

SUBMITTED TO THE WAYS AND MEANS COMMITTEE
U.S. HOUSE OF REPRESENTATIVES
MAY 9, 1995

The American Society of Mechanical Engineers (ASME) strongly supports legislation to make permanent the Internal Revenue Code Section 127 exclusion for employer-paid educational assistance. Section 127 expired on December 31, 1994.

The 125,000-member ASME is a worldwide engineering society focused on technical, educational, and research issues. It conducts one of the world's largest technical publishing operations, holds some 30 technical conferences and 200 professional development courses each year, and sets many industrial and manufacturing standards.

We strongly support congressional efforts, in particular H.R. 127, to make permanent the Section 127 Internal Revenue Code employee educational assistance provisions. These provisions allow employers to provide their employees tax-free reimbursements for tuition, books, and fees for non job-related educational assistance.

Pressures of international economic competition are shaping a new environment for employer-employee relationships, requiring greater job flexibility, job mobility, and frequent updating of skills. The American demographic trend toward an older work force, the continuing shift toward a service economy, and rapid advances in knowledge and technology clearly point to the need for public policies which support and encourage lifelong education.

Continuing education and retraining programs are especially critical for engineers to keep up-to-date with rapidly changing technology in their field or to switch areas of engineering specialization. Moreover, a well-trained engineering work force is vital to our nation's economic well-being.

Section 127 of the Internal Revenue Code has exempted qualified employee educational assistance from employee federal income taxes. The Section's expiration has caused confusion and concern among participants in this program. In the absence of Section 127, the law requires employees to pay taxes on tuition payments made by their employers unless the courses are strictly "job-related." The expiration of the Section 127 provisions is keeping many engineers from pursuing the advanced degrees they need to compete, and to help our nation compete, in the ever-changing world of engineering technology.

Section 127 has had an important role to play in the retraining of engineers employed by the defense dependent industries impacted by defense downsizing. Employee educational assistance would provide these engineers with the opportunity to continue their education in new fields of engineering technology which can be used in both military and civilian applications. This in turn would assist the defense industry in expediting the conversion of their products from defense to domestic markets.

Section 127 works. Since 1978, employee educational assistance has enabled more than seven million American workers to upgrade their skills and keep pace with new competitive, technological, and industrial developments. Over 95 percent of the participants in ASME's continuing education courses in the Society's professional development program have been supported by their employers through tuition reimbursement.

We believe that Section 127 is analogous to the GI Bill of Rights: an investment in the future. In our experience, continuing education is an investment, not a fringe benefit. It should be considered a business expense, required for a company to remain competitive. With the appropriate mix of educational programs, we can improve our quality of life while improving the nation's industrial competitiveness and balance of trade; we can improve productivity while improving the quality of our products.

Finally, we believe that permanent implementation of Section 127 would not be a revenue loser for the federal treasury. We believe the revenue foregone from not taxing employee educational assistance will be recovered many times over in additional tax revenues from economic activities generated by a continuously employed, well-educated work force. It should also be noted that the "cost" of Section 127 is very low compared to the alternative of expanding direct funding for educational programs and retraining.

In conclusion, we urge Congress to move expeditiously to make Section 127 a permanent part of the Internal Revenue Code. It is a critical component of the national effort to enhance the education, job skills, and retraining of American workers. Clearly, Section 127 is a cost-effective investment in the future of America.

STATEMENT OF THE ASSOCIATION OF AMERICAN RAILROADS
on the
ELIMINATION
of the
1.25 CENT-PER-GALLON DEFICIT REDUCTION FUELS TAX
submitted to the
SUBCOMMITTEE ON OVERSIGHT
OF THE
HOUSE COMMITTEE ON WAYS AND MEANS

May 9, 1995

The Subcommittee on Oversight's hearing on the October 1, 1995, expiration of the aviation jet fuel exemption from the Transportation Fuels tax presents an opportunity to examine a clear tax inequity assessed against America's railroads. Effective October 1, 1995, the railroads will be unfairly left as the only transportation mode paying the 1.25 cents-per-gallon deficit reduction fuel tax. It is simply discriminatory to require railroads to pay 1.25 cents more per gallon towards deficit reduction than their major competitors. The Association of American Railroads strongly urges, as a matter of fundamental fairness, that all modes of transportation should pay the same fuel tax toward deficit reduction.

I. UNDER CURRENT LAW BOTH RAILROADS AND THEIR MAJOR COMPETITORS CONTRIBUTE EQUALLY TO DEFICIT REDUCTION.

Prior to the 1990 Reconciliation Act, the sole purpose of the transportation fuels tax was to finance the Highway Trust Fund. Therefore, railroads (like other off-highway users) did not pay this tax. The 1990 Act arbitrarily extended the fuel tax beyond its historical role as a highway user fee, by introducing a 2.5 cents-per-gallon deficit reduction tax on transportation fuels.

The original 2.5 cent tax was payable by most transportation modes (except barges) into the general fund of the Treasury. The 1993 Reconciliation Act imposed an additional 4.3 cents-per gallon deficit reduction rate on all transportation modes, in addition to modifying the 2.5-cents rate. At present and until October 1, 1995, both railroads and trucks pay a combined deficit reduction rate of 6.8 (4.3 plus 2.5) cents-per-gallon of transportation fuel.

II. UNDER 1993 AMENDMENTS SCHEDULED TO TAKE EFFECT ON OCTOBER 1, 1995, RAILROADS WILL BE AT AN UNFAIR COMPETITIVE DISADVANTAGE, BECAUSE THEY WILL BE REQUIRED TO PAY MORE TOWARDS DEFICIT REDUCTION THAN THEIR COMPETITORS.

Under the 1993 Reconciliation Act, the 2.5-cents tax paid by highway users will be redirected into the Highway Trust Fund. Thus, on October 1, 1995, railroads will be left as the only payers of the original deficit reduction tax at a rate of 1.25 cents-per-gallon. As a result, on October 1, 1995, highway users will pay only 4.3 cents-per-gallon into Treasury's general fund, while railroads will pay 5.55 (4.3 plus 1.25) cents-per-gallon for deficit reduction. Thus, the railroad industry will be at an unfair competitive disadvantage, unless the deficit reduction rate levied on the railroads is reduced to the level of its competitors.

III. THE DEFICIT REDUCTION FUEL TAX IMPOSED ON RAILROADS SHOULD BE REPEALED, TO THE EXTENT THAT ANY PORTION OF THE TAX PAID BY HIGHWAY USERS IS DIVERTED TO THE HIGHWAY TRUST FUND.

Tax equity requires the recognition of basic differences regarding the financing of infrastructure used by competing modes of surface transportation: (1) the Highway Trust Fund, funded by highway user taxes, provides the financing for the construction and maintenance of the public roads used by trucks, while (2) the railroad industry operates over its own privately funded rights-of-way, with respect to which the industry pays significant property taxes. Thus, the railroads's fuel tax payments should never be diverted to the Highway Trust Fund; such a result would unfairly force the railroads to pay for the infrastructure used by their competitors (in addition to their own). Moreover, because the railroads do not enjoy, require, or want a trust fund, the diversion of the excise tax paid by trucks into the Highway Trust Fund should be balanced by the repeal of the fuel tax paid by railroads.

IV. ALTERNATIVELY, TO AVOID ANY REVENUE SHORTFALL, THE SAME AMOUNT OF TAXES RAISED BY THE 1.25-CENT RATE ON RAILROADS CAN BE GENERATED BY REQUIRING DEFICIT REDUCTION PAYMENTS AT A LOWER RATE BY ALL MODES OF TRANSPORTATION.

The alternative proposal would allow fuel taxes paid by the other modes to be directed into their respective trust funds in a revenue neutral manner, with all modes contributing equally to deficit reduction. For example, a .028 cent-per-gallon tax on fuel used by the same transporters, including railroads, subject to the 1993 deficit reduction tax would raise enough revenue to eliminate the 1.25-cent discriminatory tax on railroads. As long as the fuel tax is viewed as an appropriate vehicle for deficit reduction, all transporters should be required to make equal contributions.

CONCLUSION

Competing modes of surface transportation should be required to make equal contributions to deficit reduction. The Association of American Railroads urges the elimination of the 1.25 cent-per-gallon deficit reduction tax on railroads (scheduled to take effect on October 1, 1995) as a matter of fundamental fairness.

STATEMENT OF J. VERNON HINELY
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
CARBONIC INDUSTRIES CORPORATION
on the
ELIMINATION OF THE UNINTENDED TAX SUBSIDY FOR CARBON DIOXIDE PRODUCED AS A BY-PRODUCT OF ETHANOL
submitted to the
SUBCOMMITTEE ON OVERSIGHT
of the
HOUSE COMMITTEE ON WAYS AND MEANS

May 9, 1995

I. INTRODUCTION

The Subcommittee on Oversight's hearing on the expiration of the aviation jet fuel exemption from the Transportation Fuels tax presents the opportunity to review a related issue involving the way in which the fuel tax exemptions for ethanol have disrupted the traditional carbon dioxide ("CO2") market by virtue of the unintended subsidy made available to ethanol-based CO2. I and others in my industry strongly urge, as a matter of fundamental fairness, the enactment of legislation to "back out" the cost advantage that ethanol producers obtain when they co-generate CO2 for sale in the retail market.

The Cato Institute recently identified the ethanol tax subsidies as a prime target for "corporate welfare reform." At the very least, these tax subsidies should be reduced, because a federal subsidy is unnecessary to the extent current law already enables ethanol producers to supplement their revenues by selling CO2 at retail.

II. THE CARBON DIOXIDE INDUSTRY MATURED WITHOUT THE AID OF FEDERAL SUBSIDIES

A mature (half billion dollar a year) CO2 market developed in this country without the benefit of federal government subsidies. Refined CO2 has countless commercial applications, including food preservation, beverage carbonation, water treatment, and firefighting. Because there are few natural CO2 gas wells, the primary source of CO2 is as an industrial by-product, particularly from ammonia production and petroleum refining.

CO2 is a gas that is found naturally in our atmosphere. The commercial production of CO2 begins with CO2 in a gaseous state; liquid CO2 is produced by cooling and compressing carbon dioxide gas under high pressures. Below -69.9 degrees Fahrenheit, liquid CO2 freezes to form a solid (known commonly as "dry ice").

It is uneconomic to transport crude CO2 gas, even over a distance as short as a quarter of a mile. For this reason, CO2 refining operations[1] are located at the source -- that is, a CO2 company's recovery and processing equipment must be connected to an unrelated supplier's industrial plant. The economics of transporting raw CO2 also explains why there is no national wholesale market for this commodity; instead, there are overlapping regional wholesale markets.

The aggregate wholesale market is a "seller's market," characterized by sharp competition for reliable streams of CO2 of sufficient purity and volume. Not surprisingly, longterm "take or pay" supply contracts are prevalent. The typical CO2 supply contract has a term of 15 years and calls for a fixed price.

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[1] A merchant liquid carbon dioxide plant consists of filtration, compression, and refrigeration equipment with related controls, instrumentation, and storage.

III. THE ETHANOL MARKET AS WE KNOW IT TODAY WOULD NOT EXIST BUT FOR FEDERAL TAX SUBSIDIES.[2]

Ethanol is an alcohol that may be produced from a variety of feedstocks, although about 95 percent of current ethanol production is derived from corn. Beginning in 1978, the Congress enacted five tax incentives to encourage the use of ethanol in gasoline and diesel: (a) exemptions from the motor fuels excise taxes on gasoline and diesel (generally referred to as the "Gas tax"); (b) a blender's tax credit; (c) a small ethanol producers tax credit; (d) tax deductions for clean-fuel burning vehicles; and (5) the alternative fuels production tax credit. Since the enactment of the first Gas tax exemption, the ethanol fuels market has expanded from a few million gallons per year prior to 1978 to over a billion gallons per year today.[3]

A. The Gas Tax Exemption Has Been The Most Effective Federal Tax Incentive In Stimulating Ethanol Production.

The Gas tax is imposed at the rate of 18.4 cents per gallon on gasoline and 24.4 cents per gallon on diesel used in highway motor vehicles. 11.5 cents of the 18.4 cents rate (17.5 cents of the diesel tax rate) finances the Highway Trust Fund.[4] While the Gas tax has always had an expiration date (and is currently scheduled to expire on October 1, 1999) it has always been extended before expiration.

1. The Internal Revenue Code Provides For Three Tiers Of Exemptions, Depending On The Percentage Of Ethanol Per Gallon Of Gasoline.

Gasohol -- blends of gasoline and ethanol that are at least 10 percent ethanol -- is exempt from 5.4 cents of the 18.4 cents Gas tax; thus, gasohol is taxed at only 13 cents per gallon. Mixtures of gasoline and ethanol that are at least 7.7 percent ethanol are exempt from 4.16 cents of the Gas tax, and mixtures that are 5.7 percent ethanol are exempt from 3.08 cents of the Gas tax. Straight alcohol fuels also qualify for Gas tax exemptions. Ethanol that qualifies for the Gas tax exemption must meet two definitional requirements. First, the ethanol cannot be derived from petroleum, natural gas, or coal (including peat). Secondly, the ethanol must be at least 190 proof (or, 95 percent pure alcohol, determined without regard to any denaturants). The Gas tax exemptions for ethanol expire after September 30, 2000.[5]

2. The Economic Benefit Of The Gas Tax Exemption Goes To Ethanol Producers.

The Gas tax is levied -- and the exemption is claimed -- at the time gasoline is removed from a "terminal" (a gasoline storage and distribution facility that is supplied by pipeline or vessel). Although the owner of the gasoline (e.g., a major oil company) is liable for the Gas tax, it is the ethanol producer that receives the economic benefit of the

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[2] The market information in this section was drawn from a recent analysis of the Federal tax incentives for ethanol: Alcohol Fuels Tax Incentives and EPAs Renewable Oxygenate Requirement, by Salvatore Lazzari, Specialist in Public Finance, Economics Division, Congressional Research Service, The Library of Congress (94-785 E) October 7, 1994.

[3] Further Administrative actions by the Environmental Protection Agency ("EPA") and Internal Revenue Service ("IRS") artificially increase the demand for ethanol. First, the EPA interpreted the Clean Air Act as giving it discretion to require that a portion of required oxygenates be derived from renewable resources, and mandated 30 percent; the U.S. Court of Appeals for the District of Columbia, however, struck down this rule on April 28, 1995. The EPA requirement effectively mandated the use of ethanol, as the technology for producing the alternative -- methanol from biomass -- is experimental and uneconomic at present; if the court case is not appealed, the case would not prevent refiners from using etanol voluntarily. Secondly, the IRS has ruled that ETBE (Ethyl Tertiary Butyl Ether, a compound --not an alcohol-- resulting from a chemical reaction between ethanol and isobutylene) qualifies for the blenders tax credit noted above.

[4] The other components of the 18.4 and 24.4 cents tax rates are a 6.8 cents Deficit Reduction rate and a .1 cent Leaking Underground Storage Tank ("LUST") rate.

[5] Regarding the difference between the dates of expiration of the Gas Tax and the exemptions, the exemptions have always been drafted to expire after the Gas Tax

Gas tax exemption. This is so because ethanol producers set their prices to be equal to the Federal tax subsidy plus the current price of unleaded gasoline[6]. Further, it is the invoice supplied by the ethanol producer that the Internal Revenue Service ("IRS") relies on in determining whether taxpayers that claimed Gas tax exemptions have complied with the definitional requirements as to source and proof of ethanol.

Note that the IRS's acceptance of an ethanol producer's invoice as proof of compliance with source and purity requirements is not misplaced. Because ethanol producers are makers of alcohol, they are closely monitored by the Bureau of Alcohol, Tobacco, and Firearms ("ATF"). Thus, the IRS can be fairly confident that an ethanol producer will have few (if any) opportunities to engage in noncompliance.

B. Ethanol Tax Credits Are Available In Lieu Of the Gas Tax exemption.

The "Blenders" credit is 54 cents per gallon of ethanol that is used in a mixture of alcohol and gasoline and sold as a fuel or used by the blender in its trade or business as a fuel. A separate 10 cents per gallon credit is provided for small ethanol producers (defined as one with ethanol production capacity of not more than 30 million gallons per year). A 54 cents per gallon credit is also available for straight ethanol. While the Gas tax exemption reduces revenues to the Highway Trust Fund, the ethanol credits reduce general revenues.

The alcohol fuel credits are designed to provide the same economic benefit as the 5.4 cents Gas tax exemption. Generally, a taxpayer has the choice of the credit or the exemption, but not both.[7] Taxpayers prefer the Gas tax exemption over the income tax credit, primarily because the exemption provides an immediate tax benefit while the credit is not claimed until an income tax return is filed (and is useful only to the extent of tax liability). Further, the exemption is more profitable, because the amount of credit is subject to tax and so the after-tax benefit is reduced to 35 cents per gallon (a 54 cents credit minus the 54 cents included in income and taxed at the 35-percent corporate income tax rate).

C. The Ethanol Industry Is Now Using Its Government Subsidized Cost Advantage to Compete In The Retail CO2 Market.[8]

Fermentation of grain in an ethanol plant generates CO2: 6.8 pounds of CO2 are produced per gallon of ethanol.[9] Utilizing their enormous capacity to generate CO2, ethanol producers are competing directly with traditional CO2 companies selling at retail.[10] The vast quantities of CO2 available to ethanol producers is a direct but unintended consequence of the Federal tax subsidies for ethanol. Because ethanol producers source their raw CO2 from themselves at virtually no cost,[11] they enjoy a competitive edge over traditional CO2 companies that purchase and refine CO2 without the benefit of a Federal tax subsidy.

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[6] See page 5 of the 1994 CRS analysis cited in note 2, above.

[7] A mixture that is more than 10 percent ethanol is eligible for both the exemption and the credit, but in such a case the credit is reduced by the amount of the exemption.

[8] See "Fed Subsidy a Gas for one Biz, a Fizzle for Other," Crain's (Metro Chicago's Business Authority) Sept. 12-18, 1994.

[9] As calculated by the Congressional Research Service in the memorandum, dated February 15, 1994, entitled "Carbon Dioxide from Ethanol Production" by David E. Gushee, a senior fellow in environmental policy.

[10] See "Improve Ethanol Project Economics With Carbon Dioxide Recovery Capability," from the Sept./Oct. 1993 issue of Fuel Reformulation magazine.

[11] See the Congressional Research memorandum cited in note 9, above.

IV. A FEDERAL TAX SUBSIDY IS UNNECESSARY TO THE EXTENT CURRENT LAW ALREADY ENABLES ETHANOL PRODUCERS TO SUPPLEMENT THEIR REVENUES BY SELLING CO2 AT RETAIL.

A. Groundwork For A Corrective Amendment Was Laid During The Last Congress.

The unintended effect of ethanol subsidies on the CO2 industry was the subject of a hearing during the last Congress where I testified before another subcommittee of the Ways and Means Committee.[12] Further, the staff of the Joint Committee on Taxation ("Joint Tax") did some preliminary work on estimating the revenue that could be raised by backing out the unintended tax subsidy for ethanol-based CO2. The proposal described herein does not involve the imposition of a new tax and would be designed to enhance revenues.

B. Current Law Should Be Amended To Reduce The Ethanol Tax Incentives By An Amount That Corresponds To The Advantage Gained In The Retail CO2 Market.

1. The Proposal Would Provide Reduced Exemption Rates For Ethanol That Is Co-generated With CO2, (Just As Current Law Already Provides Different Rates Depending On The Percentage of Ethanol).

Except in the case of alcohol produced by small ethanol producers, the proposal would provide different rates for ethanol that is co-generated with marketable quantities of refined CO2. The invoice rendered by an ethanol producer would indicate whether the alcohol was co-generated with CO2 for sale at retail. Just as under current law, ATF monitoring of ethanol production facilities should obviate any concern about non-compliance with the proposed definitional requirement. In this regard, note that the logistics of recovering and refining CO2 requires the location of a merchant liquid CO2 plant at the site of the ethanol production facility. (In contrast, the sale of CO2 by-product as crude gas eliminates much of the capital and operating expense associated with refining CO2 for sale at retail).

2. The Reduced Rates Would Be Designed To Enhance The Revenue Raised By The Proposal.

In the first instance, the reduced exemptions would not be prohibitive; that is, the rates should be set so ethanol remains competitive with other oxygenates (such as methanol). At the same time, the exemptions should take into account the supplemental revenues generated by retail sales of CO2, because it is in the retail market that ethanol producers realize the cost advantage made possible by the Federal tax subsidy.

As a starting point, the cost advantage enjoyed by ethanol producers can be quantified as follows:

(a) The average purchase price of crude CO2 is $15 per ton (exclusive of transportation and other indirect costs);

(b) It takes 294 gallons of ethanol to produce a ton of CO2 (6.8 pounds of CO2 is produced for every gallon of ethanol; and two thousand pounds divided by 6.8 is equal to 294); thus,

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[12] See "Testimony of J. Vernon Hinely, Chairman and Chief Executive Officer of Carbonic Industries Corporation, before the Subcommittee on Select Revenue Measures of the Committee on Ways and Means, on September 23, 1993."

(c) For every gallon of ethanol, a producer saves 5 cents ($15 -- the per ton purchase price for crude CO2 -- divided by the 294 gallons of ethanol required to produce a ton of CO2).

While the 5 cents per gallon savings is a clearly identifiable cost advantage that ethanol producers have over traditional CO2 companies, the revenue estimate should assume the rate reduction that would result in the smallest decline in production of ethanol-based CO2.

3. Conforming Amendments To The Ethanol Tax Credits Would Be Necessary.

Because the ethanol tax credits are designed to be equivalent to the Gas tax exemptions, the credits should be conformed to the applicable rates for ethanol that is co-generated with refined CO2

V. CONCLUSION

The Congress never intended to subsidize the production of carbon dioxide, yet that is exactly what has occurred as a result of the Gas tax exemption and related provisions of the Internal Revenue Code. As a matter of fairness and equity, I urge the enactment of the proposal that would mitigate the effects of the ethanol tax subsidy on the carbon dioxide industry by reducing the tax subsidies for ethanol that is produced as part of a process that includes co-generating and refining carbon dioxide for sale at retail.

STATEMENT OF THE COLLEGE AND UNIVERSITY PERSONNEL ASSOCIATION, SUPPORTING EMPLOYEE EDUCATIONAL ASSISTANCE (I.R. CODE SECTION 127)

The College and University Personnel Association (CUPA) is a nonprofit association that represents over 1,700 private and public college and university human resource departments throughout the United States and has an individual membership of more than 6,000 members. Our primary mission is to provide information and leadership to college and university human resource departments. Therefore, CUPA would like to submit the following written statement for the record in support of Section 127 Educational Assistance of the Internal Revenue Code (IRC).

As you are aware, Section 127 allows employers to provide up to $5,250 a year in nontaxable reimbursements or direct payments to employees for tuition, fees, and books for both undergraduate and graduate courses. Although not specifically classified as a fringe benefit, Section 127 is treated similarly to and is comparable with other benefits such as health care insurance, pension plans, and life insurance. If employers choose to provide educational assistance benefits to their employees, they must offer the benefits to all employees on a nondiscriminatory basis, which does not favor highly compensated employees.

Section 127 of the IRC was enacted first as part of the Revenue Act of 1978. Prior to 1978, only educational assistance provided by an employer to an employee that related to the individual's job was excluded from an employee's gross taxable income. The "job-related" test contained in Internal Revenue Regulation 1.162-5 was confusing and resulted in both the Internal Revenue Service and the courts making arbitrary decisions as to what type or types of employer-provided educational assistance successfully met the test of job relatedness. Additionally, most entry-level employees were unable to claim an exemption for an educational expense because their job descriptions and responsibilities were not broad enough to meet the test. In effect, only highly skilled individuals were able to use job-related educational assistance.

The 1978 effort to enact legislation to cover employer-provided educational assistance was led by Representatives Guy Vander Jagt (R-MI) and Frank Guarini (D-NJ) and received wide bipartisan support. The sponsors of the legislation believed that enactment of the provision would help to meet three goals: (1) clarify the tax treatment of employer-provided non-job-related educational assistance and job-related educational assistance; (2) reduce the inequity among taxpayers; and (3) provide less-educated and skilled employees with opportunities for upward mobility and advancement through employer-provided educational assistance. Since the 1978 enactment, supporters of Section 127 inside and outside of Congress believe the provision continues to meet the goals expressed by the original supporters of the legislation.

Due to revenue constraints, Congress has reinstated Section 127 predominantly through one to two year extensions. The last reinstatement was enacted in the Omnibus Budget Reconciliation Act of 1993 (OBRA '93) and expired on December 31, 1994. In the 104th Congress, Representatives Clay Shaw (R-FL) and Sander Levin (D-MI), Charles Rangel (D-NY), David Camp (R-MI), and Richard Neal (D-MA) have introduced a bill to reinstate Section 127 retroactively and make it a permanent part of the IRS code.

As an association that represents human resource departments at higher education institutions, CUPA is in a unique position to evaluate the effectiveness and significance of Section 127 benefits, from the perspective as both the providers of educational instruction and human resource professionals.

As higher education professionals, we witness firsthand the usefulness of Section 127 benefits as they are applied by the private sector and their employees to educational pursuits. Like any other benefit, employers are not required to provide Section 127 benefits to their employees. Nevertheless, employers provide these benefits to their employees because they see value and a return on the investment in their employees' education. Employees use Section 127 benefits to keep current with changing trends in rapidly advancing fields such as engineering and computer programming, to broaden their skills and knowledge, and to improve basic reading, writing, or mathematical skills, if necessary.

Finally, as evidenced during the last economic recession, the utility, value, and flexibility of Section 127 was demonstrated readily. Companies that endured layoffs offered Section 127

benefits as outreach programs to their laid-off workers. Many of these employees were retrained for other positions with their current employer or for other employment opportunities within the community. In instances when Section 127 expires and the benefits are taxable, these unemployed individuals who receive these benefits cannot afford to pay taxes on them out of the unemployment compensation they receive. This situation discourages the laid-off employees from receiving the very training they need to rejoin the work force.

We see the significance of offering these benefits to employees to continue their education. College and universities have a difficult time competing with the private sector for employees in terms of compensation. Our members have found that Section 127 benefits are an effective recruiting method for prospective employees who might otherwise choose to work in the more highly compensated private sector. Like their counter parts in the private sector, higher education institutions also realize how important educational assistance is as an investment in human capital. By offering Section 127 benefits, the institutions receive a better-skilled, better-educated employee.

Temporary extensions of Section 127 lead to a great deal of uncertainty in the tax code. Individual recipients of Section 127 benefits -- as well as employers -- encounter the tax implication of this uncertainty every year as they wonder whether Congress once again will temporarily extend Section 127 or make it permanent. Consequently, many employees who would like to continue their education through Section 127 benefits curtail or terminate their education. When Section 127 expires, employers still may offer educational assistance but must include the dollar value of the benefit in the individual's compensation, which makes it subject to federal and state income tax withholding as well as social security and Medicare Hospital Insurance taxes. As a result of the inclusion of the benefits in their compensation, many employees must terminate their continuing educational pursuits because of tax liability.

While reviewing the role of the federal government in the workplace, Congress should consider that the one vehicle that encourages employer investment and assistance toward the goal of providing educational assistance to workers is not a permanent section of the Internal Revenue Code. The continued uncertainty in the tax code regarding Section 127 benefits is an impediment to employers who want to provide worker training and educational assistance. It is essential that Congress makes Section 127 permanent.

CUPA fully appreciates the deficit problems that face this country and the difficult choices that must be made in the budgetary process to determine which programs will be funded and which ones will be eliminated. Section 127 Educational Assistance benefits are a prudent and an economically sound investment in the workforce of this country. The result of this investment in human capital will be a better educated and more technically skilled worker who will help America's economy to compete internationally. The continued education and development of the U.S. worker are fundamental to meeting the challenges of the international marketplace. CUPA urges Congress to make a sound commitment to the continued education of the U.S. work force by making Section 127 of the Internal Revenue Code permanent.

**SUBMITTED STATEMENT OF
THE COMMUNICATIONS WORKERS OF AMERICA
TO THE SUBCOMMITTEE ON OVERSIGHT OF THE
HOUSE WAYS AND MEANS COMMITTEE
ON THE TAX EXCLUSION FOR
EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE**

The Communications Workers of America (CWA), a labor union representing more than 600,000 working men and women in the telecommunications, printing, and broadcasting industries and in the public sector, wishes to add its voice to those organizations that have testified in support of Section 127 of the Internal Revenue Code, which allows workers to receive up to $5,250 of tax-free, employer-provided educational expenses.

CWA respectfully requests the permanent extension of Section 127, retroactive to December 31, 1994. Over the years this section of the tax code has been shown to be a proven means for the education, training and retraining of American workers.

Our own union has used this tax exclusion extensively since its enactment. To date, workers represented by CWA in such telecommunications companies as AT&T, Ameritech, Bell South, U.S. West, Cincinnati Bell, Bell Atlantic and NYNEX have all improved their skills through use of the exclusion.

We have found it to be an invaluable tool which contributes to American productivity and competitiveness in the global marketplace. This tax exclusion helps our union members to acquire additional skills so they can maintain future employment security in new fields and new occupations, whether inside or outside the companies we represent.

To give some examples:

In 1994, in the U.S. West "Pathways to the Future" program, **13,283** employees used the exclusion to enroll in at least one course or program during the year. This represents approximately **27 percent** of the employees eligible. The enrollment-related expenditures (tuition, required fees and books) totaled **$13,587,644.**

During the life of the program, January 1993 through December 1994, **17,588** employees (**36 percent** of those eligible as of January, 1994) have enrolled in at least one course or program during this period. Related expenditures for tuition, fees and books totaled **$23,763,821**, or an average of **$1,351** per student.

It is interesting to note that since January 1, 1995, when Section 127 expired, there has been a dramatic drop in enrollments at U.S. West.

At AT&T, a program has been developed in conjunction with CWA and the International Brotherhood of Electrical Workers (IBEW), called, "The Alliance for Employee Growth and Development".

Funded by AT&T, and jointly administered by the company and its two unions, the program covered **2,909** active AT&T bargained-for employees and **2,140** laid-off AT&T bargained-for employees during the period from May 1, 1994 through April 30,1995. The Alliance paid out **$3,096,158** for tuition, fees and books to help in the training and retraining of these workers.

The bottom line is that this is one part of the tax code that works. The telecommunications industry is constantly undergoing change. In order for its workers to keep productive in this world of new technology and change, they must be constantly trained and retrained.

The world of telecommunications is also highly competitive. We estimate that since the break-up of AT&T in 1984, hundreds of thousands of workers have lost their jobs because of bottom line downsizing by AT&T and the Bell telephone companies. Retraining programs based on Section 127 have enabled tens of thousands of these workers attain the new skills they need to go on to other jobs, and thus not become a burden upon society.

For these and many other reasons, the Communications Workers of America (CWA) urges the subcommittee to extend Section 127 on a permanent basis, and make it retroactive to December 31, 1994.

Connecticut Farm Bureau Association, Inc.

FOR THE RECORD
Permanent Extension of H-2A - FUTA Tax Exemption

Subcommittee on Oversight
House Ways and Means Committee

Dear Chairwoman Johnson and Subcommittee Members:

On behalf of 4000 members families of the Connecticut Farm Bureau, and more than one hundred Connecticut farms that utilize the H-2A program, I urge your consideration in making permanent the exemption from the provisions of the Federal Unemployment Tax Act for wages of H-2A employees.

H-2A workers are admitted to the United States under Section 101(a)(15)(H)(2)(a) of the Immigration and Nationality Act to perform agricultural labor for limited periods of time. H-2A workers are employed across the United States. In Connecticut, H-2A workers are employed by farmers that produce apples, vegetables and tobacco.

The vast majority of Connecticut farms that employ H-2A workers are family farms. Though H-2A workers are employed throughout the growing season, the greatest number are employed during the critical harvest season, especially for the apple harvest. Without H-2A workers, many of these farms would not survive due to the scarcity of a trained and motivated local labor supply which is within economic means of the farm enterprise.

The permanent extension of the FUTA exemption is crucial to the farms involved in the H-2A program, because it is one of the factors that helps maintain the costs of the program within economic reason for the Connecticut farmer. If farmers using H-2A workers were not exempt from FUTA, federal, as well as state unemployment taxes would increase and result in a significant negative impact upon Connecticut producers. These increased costs would be especially burdensome in Connecticut. Connecticut producers already face one of the highest costs of doing business in the nation. Unfortunately, very few of these high or increased costs can be passed onto the consumer, because Connecticut farm products face stiff national and international competition where farm production costs are generally much lower.

Connecticut agriculture needs the H-2A program as well as a permanent exemption from FUTA in these regards. Your positive consideration of our request would be greatly appreciated.

Sincerely,

Norma O'Leary

Norma O'Leary
President

The Honorable Michael D. Crapo, M.C.
TESTIMONY BEFORE THE
HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT
HEARING ON TAX EXEMPTION EXTENSIONS
FEDERAL UNEMPLOYMENT TAX (FUTA)

Tuesday, May 9, 1995

RE: RENEWAL OF FEDERAL UNEMPLOYMENT TAX ACT EXEMPTION FOR H-2A AGRICULTURAL WORKERS

Chairman [Nancy] Johnson, Ranking Member Robert Matsui, and distinguished Members of the Subcommittee on Oversight, I appreciate the opportunity to testify today concerning the need to renew the Federal Unemployment Tax Act (FUTA) exemption for H-2A agricultural workers.

The H-2A program (administered by the Immigration and Naturalization Service) brings in foreign temporary workers under Section 101(a)(15)(H)(ii)(a) of the Immigration and Nationality Act to perform specific jobs. Without this exemption, these workers would be forced to return home to their own country since they are here under contract to do one specific job. As of December 31, 1994 this exemption once again has terminated, and needs to be renewed retroactively to January 1, 1995. Employers are concerned that paying these federal (and state) unemployment taxes for H-2(A) workers would be an undue burden. I have previously submitted a letter this year to the Subcommittee on Human Resources on this matter, and again appreciate Chairman Johnson's gracious consideration and the cooperation of her Oversight Subcommittee on my requests.

It is my hope that the House Ways and Means Committee will agree with my position and the position of many sheepherders in Idaho in permanently extending the FUTA exemption for H-2A for agricultural workers. Thank you for your consideration of this meritorious extension proposal and I look forward to working with Members of the Ways and Means Committee in furthering this extension.

IDAHO FARM BUREAU FEDERATION

FOR THE RECORD
STATEMENT OF THE IDAHO FARM BUREAU FEDERATION
Re: FUTA/H-2A Exemption

May 16, 1995

United States House of Representatives
Ways and Means Subcommittee on Oversight

Madam Chairman and Members of the Subcommittee:

The Idaho Farm Bureau Federation strongly supports the permanent exemption of H-2A workers from the Federal Unemployment Tax Act (FUTA). When Unemployment Insurance (UI) was created by Title III of the Social Security Act of 1935, agricultural employers were specifically excluded. The law was amended in 1976 to include certain agricultural employers. However, **temporary agricultural workers admitted to the United States under the H-2A program were exempted and have been on four other occasions since that time.** The most recent exemption expired January 1, 1995.

The IFBF supports a **permanent FUTA exemption for H-2A workers** for the following reasons:

1. H-2A non-immigrant alien workers are admitted to the United States only for the period of their specific work contract.
2. H-2A workers **must return home at the end of the employment period** and cannot meet the "ready, willing, and available to work" statutory requirement of unemployment insurance.
3. The current situation has placed agricultural employers in the position of collecting and paying payroll taxes for benefits their employees will never receive.
4. There are only 17,000-19,000 H-2A workers in the United States. Total estimated revenue is $816,000-840,000.
5. Imposition of a FUTA tax for H-2A workers increases the regulatory burden for farmers and creates additional indirect record keeping costs for the farmer as well as the federal government.

The American Farm Bureau Federation represents 4.4 million member families and specifically opposes the deduction of federal unemployment taxes from the wages of H-2A workers. The 45,000 member family Idaho Farm Bureau Federation's policy recognizes the unique nature of agricultural employment and is consistent with the AFBF's position. It is for these reasons that **we respectfully request that Congress make the H-2A/FUTA tax exemption permanent**.

Respectfully submitted,

Dennis Tanikuni
Assistant Director of Public Affairs

INDEPENDENT PILOTS ASSOCIATION

May 22, 1995

The Honorable Bill Archer
Chairman
House Ways and Means Committee
1102 Longworth House Office Bldg.
Washington DC 20515

Dear Chairman Archer:

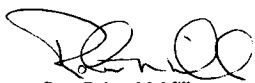
The Independent Pilots Association (IPA), the labor union representing over 1,800 airline pilots flying for United Parcel Service (UPS), writes in support of extending the commercial aviation fuel tax scheduled to be imposed on October 1 of this year. The airline industry has lost more than $13 billion since 1990, and the imposition of the fuel tax this year will likely cause greater financial losses.

The Omnibus Budget Reconciliation Act of 1993 requires the aviation industry to pay a 4.3 cents per gallon tax on jet fuel beginning in October unless an extension is granted. This fuel tax will cost U.S. airlines more than $527 million annually. For UPS in particular, it will cost approximately $15 million annually. Already the airline industry pays approximately $6.5 billion in Federally-mandated taxes and fees. To mandate and further burden the industry with an additional tax is unfair.

Nearly 120,000 airline employees and 125,000 aircraft manufacturing employees in the U .S. have lost their jobs since 1990. Further taxing an industry that is operating on thin profit margins will result in additional job losses. In addition, a fuel tax that costs the airline industry more money will hurt employees who have already given wage and benefit concessions.

As the airline industry continues to struggle to maintain profitability, it makes no sense to burden the industry and its employees with a tax increase. The IPA respectfully requests your support for extending the aviation fuel tax exemption.

Sincerely,



Capt. Robert M. Miller
President, IPA

THE IMPACT OF TARGETED JOBS TAX CREDIT ON EMPLOYMENT OPPORTUNITIES FOR PERSONS WITH DISABILITIES

Written Testimony Presented to the House Committee
On Ways and Means United States Congress
by Steve Zivolich

May 9, 1995

This written testimony will address the critical impact of the TJTC program on employment opportunities for persons with significant disabilities.

Integrated Resources Institute

Integrated Resources Institute (IRI), is a national non-profit agency that was established in 1988 to provide research, educational support and technical assistance to businesses and government agencies developing innovative employment opportunities for persons with disabilities.

Since it was founded, IRI has been instrumental in creating more than 15,000 job opportunities for workers with disabilities. These employment efforts have been accomplished with the active collaboration of three corporate partners: Pizza Hut Inc., Brinker International, and Restaurant Management Company. The employment outcomes and research were also fostered by grants from the U.S. Department of Education: Projects With Industry, Social Security Administration, Health and Human Services, and the Department of Labor.

It is our experience that these 15,000 jobs and related corporate commitments are a dramatic demonstration of the positive impact of TJTC. The Pizza Hut program initiative to hire persons with disabilities (Jobs Plus) began in 1988, four years prior to the passage of the ADA. TJTC was and is the primary reinforcement for Pizza Hut and these other national corporations to engage in this innovative employment effort. As a result, Pizza Hut is not only one of the largest users of TJTC, it is also the largest employer of persons with significant disabilities in the nation.

IRI's experience in designing and coordinating these corporate employment initiatives has convinced us that TJTC must be renewed to continue these positive employment opportunities for persons with disabilities.

Highest Unemployment Rate

Persons with disabilities represent at least 10% of TJTC participants under the categories of Disabled Veterans, Vocational Rehabilitation, and SSI/SSDI. In addition, the unemployment rate for 19.1 million working age persons with disabilities is estimated at 66% by the most recent Harris and associates national survey of 1994. For persons with significant disabilities (those likely to qualify under current TJTC regulations), the rate of unemployment is known to be even higher. For example, the unemployment rates for 1.9 million developmentally disabled working age individuals have been estimated at 87% (Kiernan and Stark, 1989).

According to Census Bureau data, the unemployment trend for persons with disabilities is not improving. For example, between 1980 and 1988 the proportions of working-disabled men, aged 16 to 24 years, working full-time, declined, while the unemployment rate steadily increased. As a result, the

ratio of earnings between men with disabilities and men without also fell. Similar changes were also reported for women of working age. After substantial relative gains in the 1960s and 1970s, persons with disabilities are losing economic ground in the 1980s and 1990s (Yelin, 1991). At the same time, the survey conducted by Harris and Associates documented the strength of this group's desire to work, and their frustrations about barriers to employment (Harris, 1994). In that survey, 79% of the respondents indicated that they would like to work if given the opportunity.

After three years of ADA implementation, disabled advocates realize that there has been no perceivable increase in hiring patterns by private industry. The majority of ADA litigation and employer focus has been directed to current employees with back injuries, filing complaints related to termination and accommodations. ADA is essentially a poorly funded EEOC sanctioning effort, that has little if any positive impact on the employment rate for persons with disabilities. I am not proposing that ADA is not essential to the long term Congressional goal of eliminating employment discrimination toward persons with disabilities. Rather, I am pointing out the importance of having a program like TJTC that rewards the private sector for doing the right thing, that is hiring persons with disabilities, rather than assuming that the remote possibility of punishment under ADA will really have the desired effect alone.

The cost of unemployment to U.S. taxpayers for persons with significant disabilities in SSI/SSDI and medical payments alone exceeds $57 billion each year. Of the 2.2 million SSI recipients with significant disabilities, only 172,000 or 8% are working. Social security further reports that less than 1/2 of 1% of these potential workers return to the labor force annually (Social Security Administration, 1991). In addition, SSI claims based on disability have increased by 20% since 1984, which demonstrates the lack of control on expenditure growth for a welfare approach to disabilities.

SSI was developed 17 years ago to insure persons with significant disabilities maintained an economic income above the poverty level. However, at this time, SSI benefit levels are substantially below the federal poverty level. As one state administrator commented at an SSI public meeting "...the SSI Program is simply inadequate to meet basic human needs (food, shelter, clothing, etc.)..." (SSA, 1991).

As a positive alternative to SSI and welfare the TJTC program has helped IRI to develop corporate employment programs such as "Jobs Plus" with Pizza Hut Inc., Restaurant Management Company and "TeamWorks" with Brinker International. Both Pizza Hut and Brinker have now received the National Employer of the Year Award from the President's Committee on Employment for Persons with Disabilities. The Pizza Hut Jobs Plus program alone is recognized as the most successful corporate effort to date, with more than 14,000 TJTC incentive disability placements since 1988. These TJTC corporate efforts were mentored by the OSER supported employment initiatives, and Projects With Industry and are now a significant component of federal, state, and local agency emphasis and services. The success of the

RSA federal initiative and TJTC is evident through several other significant corporate initiatives such as Marriott and McDonalds.

These private sector, corporate led efforts rely heavily on a public funded supported employment training strategy, as well as Targeted Job Tax Credit (TJTC). Rehabilitation advocates have reported that TJTC has helped offset some of the additional support employees with disabilities require from employers. As a result, the rehabilitation field believes that TJTC has had a significant positive effect on hiring (ARC, 1993).

Comparative Benefit-Cost Analysis of TJTC

In 1991 we concluded a two-year economic evaluation study comparing the resource costs and pecuniary outcomes of a TJTC employment program serving individuals with significant disabilities for the Social Security Administration.

The research focused on the benefit - cost of placing and supporting TJTC and SSI eligible persons with significant disabilities into employment.

The economic analysis utilized was an ex post facto evaluation study analyzing the costs and pecuniary outcomes of an employment program serving individuals experiencing significant disabilities in Pizza Hut over two years.

Characteristics of Sample Population

Fifty-nine TJTC participants from 10 states were included in the Job Plus Mentor (JPM) program sample. Inclusion in the evaluation study was based on entry and participation in the program between July 1, 1990 and January 31, 1991 (a six month period). Seventy-five percent of the participants were identified with some level of intellectual disability, while the remaining 25% were described in terms of other primary disabilities. The majority of participants (67%) did not finish high school, with 33% attending 12 or more years of school. Seventy-eight percent of the sample were Caucasian, 9% African American, and 7% Hispanic. The majority of JPM participants (84%) received SSI only, while the remaining 16% received SSI and/or SSDI benefits.

Collection of Cost Data:

Costs for the JPM program were collected on a program expenditure basis. Costs that may have been incurred through employer tax credit programs (TJTC) were also reviewed. All JPM employers participated in Target Job Tax Credit subsidies and received, on the average, $1,415 per client.

Collection of Benefit Data (Pecuniary):

According to Benson (1978), Cohen (1979), Gramlich (1981) and Taggart (1981), employment earnings are used as the major pecuniary outcome measure in employment and training benefit-cost research. In response to this convention, benefits for the study were based on wages earned for hours employed. Due to the impact of earnings data on subsequent taxes paid and reductions in welfare (transfer) payments, these latter categories were also assessed as benefits associated with each of the employment options in the study (Thornton, 1985; Collignon, Dodson, & Root, 1977; Dodson, 1979; Hill & Wehman, 1983).

Data Reduction:

Cost data from the program were converted into mean cost per worker. Program outcomes (benefits) were initially transformed into five categories: 1.) average hours worked per week, 2.) average hours worked per month, 3). average hourly wage, 4.) monthly earnings, and 5.) annual gross earnings. From these data two additional categories were added to the analysis: 6.) State and federal taxes paid on gross earnings and 7.)reductions in Supplemental Security Income (SSI) due to monthly wages.

Tax calculations were assessed at 23% of annual gross earnings. This percentage was initially established by Pechman and Okner (1974) and subsequently used by Thornton (1985), Hill, Hill, Wehman, and Banks (1985) in determining annual state and federal taxes paid by low wage earners with disabilities.

Reductions in welfare payments were computed using the SSI's standard income adjustment formula for earned income. Tax and SSI reduction formula were applied to the earnings of each participant in the JPM programs.

Rationale for Configuring Costs and Benefits:

Program costs are viewed as no cost to the participant but clearly translate into costs for taxpayers and society. Earnings benefit the participant, have no effect on the taxpayer, but when both perspectives are totaled, they equal a benefit to society. State and Federal taxes are a cost to the participant but a benefit to the taxpayer. By totaling these perspectives, the benefits and costs nullify each other, having zero impact on society at large.

Determining the benefit or cost status of Supplemental Security Income (SSI) reductions from the three perspectives is somewhat more complex. When SSI payments are reduced due to wages earned from work, this translates into a reduction of income that would have been available if the participant had not worked. Therefore, the reduction in SSI is seen as a cost to

the participant. From the taxpayer's perspective, the reduction is seen as a benefit in two ways: First, the amount of the reduced payment is a tax savings, and second, the cost of administering those funds is also saved. Thus, the taxpayer's benefit is computed by adding the reduction in SSI to the savings in administrative costs (Barnett, 1985; Thornton, 1985). From society's perspective, the reduced SSI payment is viewed as a transfer of funds from one group of people in society (the participants in the study) to another group (other welfare recipients). Hence, the reduction in SSI payments is just a shift of funds (transfer payment) and does not constitute a savings to the society as a whole. In contrast, society observes the obviated administrative costs for SSI as a savings in actual resources. Therefore, the latter are observed as a benefit to society (Barnett, 1985; Thornton, 1985).

Results: Benefit-cost Analysis:

Individuals in JPM programs benefited $1,584 annually from their participation in this TJTC model. The benefit-cost ratio for the taxpayer's investment in JPM programs equaled .74, while the ratio from society's perspective was 1.21. Thus, for every taxpayer dollar invested in JPM participants, taxpayers realized a return of 74 ¢ and society $1.21, see (Table 1).

Table 1: JPM Program Analysis:

Job Plus Mentor Program (Program B-C Analysis)			
Component	**Participant**	**Taxpayer**	**Society**
Benefits (Pecuniary)			
A. Outputs			
1. Gross Earnings	$3,978	0	$3,978
2. State & Federal Taxes	($915)	$915	0
B. Reduced Dependence On Transfer Programs (SSI)			
1. Reduction In SSI	($1,479)	$1,479	0
2. Reduction In Admin. Costs	0	$148	$148
Total Annual Benefits/Person	$1,584	$2,542	$4,126
Costs (Pecuniary)			
A. Inputs			
1. Total Annual Cost/Person	0	$2,006	$2,006
2. Target Job Tax Credit	0	$1,415	$1,415
Total Annual Cost/Person	0	$3,421	$3,421
Benefit-Cost Ratio		0.74	1.21

The benefit-cost research clearly indicates, TJTC dollars invested in the Jobs Plus program as substantially efficient. From participant, taxpayer, and society perspectives, this translates into increased levels of productivity which were not realized when greater resources were spent on individuals receiving welfare, (SSI) approaches.

Clients with significant disabilities in the Jobs Plus program experienced increased benefits by choosing to participate in the Jobs Plus program as opposed to welfare. From a public policy perspective, the Jobs Plus program clearly satisfies Cohn's (1979) criteria for public funding (B/C > 1). The return to society exceeds the point of parity for each TJTC dollar invested. These data provide a sound rationale for public support of the TJTC program.

Clearly, the programmatic strategies utilized by the Pizza Hut TJTC model reflect substantive improvement in maximizing the economic efficiency of each TJTC dollar spent on employment activities for persons with disabilities.

Benefits to Participants with Disabilities

The benefit-cost data presented is compelling in terms of describing the potential effects of TJTC policy decisions on the earning power of individuals with significant disabilities, their marketability in competitive labor markets, and the fiscal impact of habilitation decisions on taxpayers and society at large.

Three Year TJTC Survey

Through 1989 to 1991 we surveyed 4,972 TJTC employees with disabilities hired by Pizza Hut. The results indicated dramatic increases in employment opportunity, wages and tenure.

74.9% of the workers reported that they had been unemployed for the previous 6 months prior to their job with Pizza Hut. For the majority of these workers it was also their first job ever, as well as their first pay check.

The average weekly wage for these TJTC hires was a 104% increase over their previous reported wage income.

The annual turnover rate for TJTC hires was tracked at 29%, which is five times superior to non-TJTC co-workers turnover which was 170% for the same period.

Recommendations

The Pizza Hut, Brinker, and RMC TJTC programs for persons with disabilities are providing a necessary bridge between publicly funded rehabilitation programs and privately supported employee assistance programs in corporate institutions. These private sector demonstrations of TJTC programs are establishing an economically efficient and programmatically sound model for emerging public and private industry partnerships.

The conceptual framework for the TJTC programs could undoubtedly serve as a model for private industry to begin assuming the primary responsibility for post-school employment training of individuals with significant disabilities, if Congress would implement the following programmatic changes.

√ **TJTC should be made a permanent tax statute to avoid private sector reluctance associated with termination dates and the doubt of renewal.** Employers often take a wait and see attitude regarding renewal which reduces hiring activity.

√ **Develop a standardized one page TJTC authorization form for all State employment certification sources to utilize.** Currently there are 50 different

forms in use, which unduly burdens multi-state employers from implementing the program.

√ **Expand the TJTC program to all persons with disabilities.** Currently the program requires persons to be registered with their state rehabilitation agency or SSA. However, only 10% of persons with disabilities who are structurally unemployed are registered with state rehabilitation or receive SSA support.

Summary

The TJTC program had provided a necessary incentive as a bridge between publicly funded rehabilitation programs and privately supported employee assistance programs in many corporate institutions.

TJTC programs have established an economically efficient and programmatically sound model for emerging public and private industry partnerships to employed persons with disabilities. The framework of the TJTC program could undoubtedly serve as a model for private industry to expand it's TJTC efforts and begin assuming the primary responsibility for employment training of individuals with significant disabilities.

These efforts have the potential to have an even greater impact on the reduction of structural unemployment, if the program expands to all persons with disabilities and implements the efficiency strategies that have been recommended.

Structurally Unemployed

Persons with disabilities represent 10% of all TJTC authorizations. They also have the highest unemployment rate of any identified minority group.

Employment Opportunities to the Disadvantaged

TJTC jobs are providing essential initial job training and career opportunities to persons with significant disabilities who are essentially unskilled. The TJTC opportunities present the most efficient training possible for this population, by teaching job skills on the job.

Employers to Seek Out and Hire the Disadvantaged

The TJTC program is an essential component to reaching the ADA goals of employment and elimination of discrimination for workers with disabilities. Employment opportunities for disadvantaged individuals with significant disabilities have been driven in large part by TJTC.

Cost Effective Outcomes for Society

Our research indicates a positive return to taxpayers for each TJTC hire in the first year. In addition, the superior retention rate and on the job training opportunities further supports this taxpayer investment for workers with disabilities.

Improved Income, Training, and Retention

TJTC has dramatically impacted employment, wages, training and retention rates for persons with disabilities.

Thank you for the opportunity to share my written observations of a federal tax incentive program that is highly effective in its multiple goals that benefit: taxpayers, employers, employees with disabilities and our country.

I urge you, on behalf of the 9.9 million unemployed Americans with disabilities who have stated that they want to work, if just given the chance, to re-authorize, expand, and make TJTC a permanent tax credit.

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STATEMENTS OF INTERNATIONAL UNION, UNITED AUTOMOBILE, AEROSPACE & AGRICULTURAL IMPLEMENT WORKERS OF AMERICA (UAW), AND UAW-GM LEGAL SERVICES PLAN, UAW-FORD LEGAL SERVICES PLAN, UAW-AAI LEGAL SERVICES PLAN

The International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW) and the UAW Legal Services Plans (UAW-GM Legal Services Plan, UAW-Ford Legal Services Plan, UAW-Chrysler Legal Services Plan, and UAW-AAI Legal Services Plan) submit this statement to the Ways and Means Committee in strong support of H.R. 540 to permanently reinstate Section 120 of the Internal Revenue Code, making the employee benefit of prepaid legal services tax exempt and preserving the access of working and retired families to the legal system.

The Legal Service Plan came into being under the protective umbrella of the Internal Revenue Code Section 120, first enacted in 1976. This law placed prepaid legal services plans funded by employers for their employees on the same footing as other tax exempt employee benefits such as health benefits. The UAW has been in the forefront of the development of prepaid group legal services, with the first operation, UAW Chrysler Legal Services Plan, opening in 1978. For the next ten years, Section 120 expired seven times, each time receiving temporary extensions. However, group legal services continued to gain wide popularity. UAW-GM Legal Services Plan began operations in 1983 and UAW Ford Legal Services Plan began operations in 1985. On June 30, 1992, Section 120 expired and has not been renewed despite vigorous lobbying by unions and prepaid supporters and although 218 members of the House of Representatives co-sponsored a bill to reinstate the exemption. We believe that now is the time to reinstate Section 120 in order to realize Congress' original goal in creating Section 120--extending low cost, quality legal services to middle-income, working and retired Americans--during this period of renewed commitment to providing relief and balance to working and retired people.

Traditionally legal services have only been available to the very rich or the very poor. Average working Americans have been shut out of the legal system, since they did not qualify for legal aid programs and yet were unable to allocate limited financial resources to legal representation. As a result, most middle income Americans simply went without any legal assistance. This began to change after the implementation of Section 120. Unions like the UAW began taking increasing interest in negotiating group legal service plans as a means of assuring that their members have access to quality, low cost representation. Employers also supported legal services plans as they saw that for an extremely modest sum of money per worker, the employees are provided with a means of solving troubling legal issues while remaining productive members of their company.

The Legal Services Plan is now in its sixteenth year of operation. More than 800,000 workers and retirees are covered by our Plans, and when families are included more than two million persons are eligible for services under the Legal Services Plan. Although there are many prepaid plans out there, the UAW Legal Services Plan is the largest and is representative of the types of legal services provided to workers and retirees eligible for this type of benefit. Prepaid legal service plans have proven

themselves to be extremely cost effective and even the most comprehensive plan generally costs less than $100 per year per worker. Unlike many other fringe benefits, costs have not skyrocketed but instead have remained relatively stable throughout the years.

Legal Services Plans provide personal legal services on a variety of legal matters including estate planning, probate, consumer problems, the sale and purchase of homes, credit reporting problems, domestic issues, and other personal legal problems. Without Legal Service Plans, middle income people often cannot afford to see an attorney despite the seriousness of the problem they may be facing. However, prearranged access to an attorney allows people to call on an attorney when they first face the trouble, before it is too late. Because of Plans like the UAW Legal Service Plans, houses need not be lost, cars need not be seized, utilities need not be cut off, and debt problems need not grow into insurmountable problems. Through early identification and intervention, problems can be solved and stopped thereby avoiding costly distractions and disruptions to the worker's job.

The Legal Services Plan is a law firm with more than 400 attorneys, with more than 70 offices, located in the following 18 different states:

Alabama:	2 offices
Delaware:	1 office
Georgia:	2 offices
Illinois:	3 offices
Indiana:	8 offices
Kansas:	1 office
Kentucky:	1 office
Louisiana:	1 office
Maryland:	1 office
Michigan:	27 offices
Minnesota:	1 office
Missouri:	3 offices
New Jersey:	2 offices
New York:	6 offices
Ohio:	15 offices
Oklahoma:	1 office
Texas:	1 office
Wisconsin:	2 offices

In areas where there are not a sufficient number of employees and retirees to warrant establishing a Plan office, a "Cooperating Attorney" system was developed to provide benefits. Plan staff attorneys are dedicated not to serving the business or corporate or political concerns of their clients, but to solving the everyday problems of working and retired families. Our experience supports the idea that if problems are caught early, they can be resolved simply. More than 50% of Plan cases are resolved in two hours or less with advice and counseling to the client who needs help dealing with the system.

Another hallmark of this benefit is estate planning. More than 24% of the cases the Plan handles are for this type of matter. Because working families have access to legal advice, they are able to adequately prepare for their spouse, minor children, and disabled children. Without the legal service benefit, most of these people would not consult a lawyer at the planning stage thereby avoiding numerous problems for their family at their own disability or death. Beginning in August 1990, the UAW Legal Services Plan counseled hundreds of clients as to their legal rights and protection, as these workers prepared to leave for Operation Desert Storm. Wills and powers of attorney were drafted and advice was given to families of soldiers. This type of benefit not only provides tremendous peace of mind to the effected worker, but also provides a real service in terms of reducing or eliminating legal problems at the injury, disability or death of the worker.

At other times, though, Plan clients need more because they are sued or threatened with the loss of a home or another significant injury. Prepaid legal services, like the UAW Legal Service Plans, usually provide in-court representation for these clients who would otherwise give up since they would be unable to pay for the necessary legal services. Typical of these types of cases are the clients who pay contractors significant sums of money to have needed home improvement work completed, only to have no work at all done or shoddy unacceptable work completed. Although our retirees are often the victims of these scams, they are also perpetuated on honest, working people who expected fair work for a fair price.

Prepaid legal services plans assist middle-income Americans at many critical points in their lives. Typical cases handled by prepaid legal services plans include defective consumer purchases, vacation property scams, investments gone wrong, credit reporting problems, guardianships, landlord tenant problems, insurance problems, collection of disputed debts, claims arising out of the sale or purchase of real estate and defense of foreclosures and forfeitures. In 1994, more than 245,000 new cases were opened in Plan staff offices. Another 60,000 referrals were provided to retirees and workers who lived in areas without a Plan staff office. The types of cases handled under these Plans broke down as follows*:

Wills, Probate, and Estate Planning:	24.2%
Real Estate:	24 1%
Consumer cases:	20%
Family and Other Matters:	31.7%

Prepaid legal services for middle income workers and retirees address the historical imbalance that occurs when parties to a dispute are unequal financially. The UAW Legal Services Plan, like other prepaid legal services, has from the beginning sought to correct that imbalance. Without access to a legal service plan, these problems would remain unresolved, regardless of the merits of their case.

*See attachment to this document for a complete listing of Plan cases.

The Joint Committee on Taxation estimates that the revenue loss associated with Section 120 is such a small percentage of the federal budget that it would have no impact on it. However, if Section 120 is not reinstated permanently, the creation of new plans will be discouraged, while benefit dollars are shifted to other tax favored benefits. We will return to the day when middle income working and retired people were all but shut out of the legal system. This is one tax benefit that was truly aimed at working and retired people and which gave this same group of people meaningful access to our legal system. We urge you to support H.R. 540 and to reinstate and make Section 120 permanent

Some comments from our members and clients:

I find this service to be invaluable! I feel secure in contacting the service because I won't be "taken" money-wise. I like knowing that I can trust their services..I feel I can ask her advice before I do something dumb. Thank you. Burr Ridge, Illinois

My wife and I had our wills made out by one of your attorneys and were well satisfied. The second case was a problem between a hospital and me and a collection agency. Once I showed (the attorney) all the bills and receipts, he took over. He sent the agency a letter that he was representing us and all the threatening letters stopped coming. I would not hesitate to use the services any time needed. Burr Ridge, Illinois

Before my husband's death, we used the service for the legal work involved in buying our home. As a surviving spouse, I believe this to be a very valuable service. I don't know the name of the attorney who helped us for this but I do remember he was very helpful in answering our questions and helping us with the contract. Kansas, Missouri

We really feel the plan has been beneficial to us. [The attorney] saved us $2,000 with just a phone call when we purchased our lake lot. He has been most helpful and fact we have the legal service has helped resolve problems quickly. We plan to use the plan to draw up a will and ..a problem with an easement. Kansas, Missouri

I don't know what I would have done had it not been for the UAW lawyers. I have used them for bankruptcy, food stamps for my daughter and grandchildren who live with me am in the process of having my late husband's estate probated. I always look to UAW for help and advice. Oklahoma City, Oklahoma

Any legal matter is a stressful situation. Having an attorney to represent your interests not their bank account is a real relief. It is a valuable service to all UAW employees. Oklahoma City, Oklahoma

I feel this program is one when you need to use it can be invaluable. I don't have any idea how much in legal fees in the past few months I would have spent. I would definitely recommend the Legal Service to other workers who need advice of a legal problem. [My attorney] was a great asset to me through a very difficult time in my life. She provided answers to questions that would affect the rest of my life. I found her to be a great attorney as well as person. She will always have my greatest thanks for the help she gave me. Her answers to questions I had were factual and to the point. She kept me advised at all times and I would go to her for any problem. Anderson, Indiana

I consider the UAW-Ford Legal Services Plan a great benefit and importance in this day and age. It is extremely expensive to get legal help and advice especially being retired. Along with my health benefits it is comforting to know that this program is available. My thanks to UAW and Ford for making life a little easier. Clearwater, Florida

Being on a pension and considering my age, this is a necessary benefit. I could never afford to pay an attorney. In this particular case, the attorney was able to save me approximately $10,000 on the last part of my transaction, which I felt they were trying to swindle me. Attorney [ ] wrote a letter and the other party backed down. Clearwater, Florida.

Without this service that have been instances when a problem would remain a problem due to the cost of an attorney. This service has enabled me to improve my quality of life by having counsel when need to solve or work through situations that you otherwise would have to tolerate. I thank Ford & UAW for this service and would miss if it were not available to me. I hope this service becomes a permanent part of our benefit package. The office staff is responsive to needs presented and have in all cases allowed a workable solution to be found. Louisville, Kentucky

We were both very happy with the services provided. It eased our minds to know our affairs were put in order and especially made easy through the no expense condition from one of many benefits as a Chrysler employee. Thank you for this benefit and I do plan on using it for future needs. Milwaukee, Wisconsin

The UAW legal service is very good in many ways. They assist us so fast and jump right on our case. The lawyers that work for us are honest. This has saved me lots of money and time. Janesville, Wisconsin

I feel the program is worthwhile. I like the feeling I get when I know I can call for opinions on matters that concern me. I handle a lot of problems over the phone. I get comfort to

know I have access to the legal system, without having to come up with retainers. St. Paul, Minnesota

I thank God for the UAW Legal Services Plan, because it has helped me and saved time and money because I don't have to lose a lot of time off my job to handle some legal matters and the attorneys are really helpful in explaining my situations as well as represent me when in need. In my opinion, we couldn't do without this benefit and I don't want to lose it. St. Louis, Missouri

[The attorney] and her assistant were invaluable to me in the process of gaining guardianship of my mother. There were times during the first year that they assisted me when I was unsure of what to do. They have a great staff. St. Louis, Missouri

My income is so low that I can't pay myself so I am very pleased that UAW Chrysler Legal Services Plan Attorneys are available. Detroit, Michigan

I was extremely pleased with the way in which my probate was handled. Things were resolved with excellent legal advice and in a very timely and professional manner. [The attorney] proved to be very resourceful, available and courteous. I can't say enough good things about her. At a very stressful time in my life following my mother's death, she offered both legal and emotional support in a most appropriate manner. Both attorney and assistant were very prompt in returning phone calls and assuring that the case would be expedited. I strongly recommend the GM Legal Services to other UAW members. Thanks again for a job well done. Pontiac, Michigan

I was grateful to use this service upon the death of my husband. It was a great help during a difficult time. Kalamazoo, Michigan

It was unfortunate that legal services were required but [the attorney]'s professionalism certainly made the ordeal easier on my wife and me. Livonia, Michigan

I was very happy with the job that the [the attorney] performed for me. He took me by my hand and without him I would have lost some money. He is also helping us with the contract for the house we are purchasing. He takes his time to explain every question have so that I feel secure in dealing with the real estate. This is one of the best services the UAW has offered. Livonia, Michigan

This service is a great help to us because on a fixed income it's hard to make ends meet Thank you very much. Atlanta, Georgia

Cases Handled by UAW Legal Services Plans 1994

Type of Case	Cases Opened	Percentage
Wills and Trusts	31,415	12.8
Probate of Estates	11,118	4.5
Taxes	413	.2
Civil Commitment	172	.1
Guardianship	6,797	2.8
Power of Attorney	5,774	2.4
Name Change	810	.3
Birth/Marriage Certificate	438	.2
Medical Health Issues	836	.3
Income Tax	982	.4
Federal Taxation	1,643	.7
Divorce	13,572	5.6
Custody and Visitation	4,475	1.8
Support and Alimony	7,368	3.0
Adoption	1,135	.5
Paternity	1,107	.5
Other Family	4,508	1.8
Criminal	5,373	2.2
Drunk Driving	1,814	.7
Other Traffic	4,098	1.7
Juvenile	1,370	.6
Participant as Victim or Witness	820	.3
Social Security	2,577	1.1
Medicare Medicaid	1,198	.5
Unemployment Compensation	334	.1
Workers Compensation	904	.4
Other Public Benefits	153	.1
Employment	3,087	1.3
Education	977	.4
Auto Property Damage	6,632	2.7
Malpractice	1,453	.6
Assault and Battery	360	.2
Property Damage	995	.4
Other Tort	5,945	2.5
Administrative Agencies	1,454	1.2
Real Estate Purchases and Sales	27,483	11.3
Claims from Purchase or Sale	5,938	2.5
Landlord Tenant	4,972	2.0

Deeds	7,034	2.9
Foreclosure	1,847	.8
Taxes or Real Property	1,076	.4
Home Improvement	2,856	1.2
Other Real Estate	7,305	3.0
Collection Suit Against Client	4,918	2.0
Repossession or Garnishment	1,912	.8
Other Debt	5,328	2.2
Bankruptcy	4,757	1.9
Credit	4,600	1.9
Consumer Complaint	19,354	7.9
Insurance Claim or Loss	4,874	2.0
Utilities	524	.2
Client as Creditor	4,277	1.7

Statement of

Arthur A. Coia, President

Laborers' International Union of North America, AFL-CIO

May 9, 1995

The Laborers' International Union strongly supports pending legislation, H.R. 540, which would reinstate the exclusion from employee taxable income of contributions by employers to group legal service plans under Section 120 of the Internal Revenue Code.

Our Union is uniquely qualified to testify on issues affecting this important benefit for workers. Beginning as far back as 1971, in Shreveport, Louisiana, and soon after in Ohio and Massachusetts, we pioneered in the development of group legal services plans in the belief that access to legal services was as important to our members as medical care and pension benefits.

Twenty-four years later, we are convinced that we made the right decision. Thousands of workers every year find that they are able to get competent legal help through negotiated group legal services plans on serious family, financial, housing and consumer problems. Workers whose family incomes would not otherwise allow them the luxury of retaining a lawyer are able through these plans to use the justice system to assert their rights and seek remedies.

What we have been able to accomplish through qualified group legal service plans is precisely what Congress intended when it enacted section 120 in 1976. By placing legal services in the same tax category as other statutory benefits, it established the public policy principle that employers and unions should be encouraged to work out means to make basic legal services available to workers.

Section 120 was originally enacted as a five-year experiment. Policy makers were concerned about whether the benefit would wind up accruing only to highly-paid executives, whether employer contributions would be insufficient to finance the arrangement and whether inflationary pressures would escalate the cost of legal service plans, as has happened in the case of medical care.

But in considering section 120's fate in 1981, Congress agreed that none of these evils manifested themselves during the five-year trial period. In fact, legal service plans were shown to benefit low and moderate income workers on a non-discriminatory basis. The modest funding formula used to finance these plans not only was shown to provide more than adequate financial support, but costs barely increased during the period. In light of this record, Congress extended the provision for three more years, then extended it five more times for shorter periods.

Even in the face of expirations and retroactive reenactments, section 120 served its purpose. There are now approximately 3.2 million employees and retirees covered by qualified group legal service plans at an average cost of under $100 per worker per year. Since these plans also provide access to essential legal services for family members, a total of 7.6 million Americans now benefit from employer-provided legal services.

Employer-paid legal services plans have so clearly proven their value that almost no one opposes them. Everyone agrees they are a good idea and that they work. The only excuse for letting section 120 expire was that the government needed the $85 million per year attributed to section 120. That was a tax increase on middle class Americans and, to a lesser extent (because of Social Security contributions), on enlightened employers who provided this proven benefit. Reinstating section 120 would rescind that tax increase.

Plans Solve Problems.

The legal services plan tax provision excludes from an employee's gross income the first $70 contributed by his employer to a qualified legal services plan. These plans provide advance arrangements for meeting personal legal needs, especially for legal services that prevent or settle disputes. Legal services plans:

>promote individual happiness and family harmony by preventing or resolving serious legal problems

>increase the quality of justice by making legal advice more available to the average citizen

>improve economic productivity, because an employee distracted by legal difficulties isn't fully effective.

Legal services plans enjoy broad, strong support from labor, consumer, bar and insurance groups. There is no opposition to legal services plans. Plans are in the best American tradition of pragmatic, voluntary group action to meet common needs.

Section 120 puts legal services plans on an equal footing with other statutory fringe benefits. Legal services plans benefit primarily middle and working class Americans and are especially popular with union members. Even the most comprehensive plans seldom cost more than $150 per family per year.

Legal services plans exhibit considerable diversity in structure, cost and benefits, depending on the group of people covered--their number, geographic distribution, family situation, etc.--and the funding available.

Plans members receive mainly preventive legal services that often make it possible to avoid litigation or serious or protracted remedial services. Thus, group legal plans tend to preserve employee morale and productivity and assist in unlocking our overburdened judicial system.

Why Plans Work

What is it about legal plans that creates "win-win" situations, where everybody benefits? Basically, it is that transaction costs are reduced when advance arrangements are made on a group basis for providing needed legal services. Advance payment is not as important as advance arrangements that make legal services readily available. These advance arrangements dramatically reduce the time, cost and uncertainty involved in selecting and consulting a lawyer when a legal question arises.

People covered by a plan contact a lawyer more often, but at an earlier point in the course of a problem. More people receive legal advice, about more matters, but matters are handled at lower cost and in a way that minimizes disputes and litigation.

Plans Help Working People.

In enacting section 120 in 1976 Congress meant to encourage more equal access to legal help for middle income Americans. You succeeded. The Treasury's own June 1988 study of legal services plans found that "plans covered by section 120 did provide relatively greater access to legal services to production workers and union members" (than to professional and administrative employees). "(T)his pattern stands in stark contrast to most other kinds of employee benefits, which are relatively less available to production employees." (emphasis added)

Without section 120 a business has an unfair advantage in any dispute with a consumer. The business' legal expenses are deductible but the consumer's are not. The landlord's legal bills are deductible, the tenant's defense of his home is not. Legal services plans offer a way for tenants, consumers and the large majority of Americans to enjoy better access to legal help without the federal government taking the expensive step of making personal legal expenses deductible or vastly expanding federal legal aid.

No Bureaucracy

I must mention that these plans are privately administered. The lawyers who provide services to plan members are mostly in private practice, and all are subject to state rules of practice. The plans themselves are regulated through ERISA like other employee benefit plans.

Tax Increase Threatens Progress

All employees covered by an employer-paid group legal services plan suffered a tax increase when section 120 expired. So did contributing employers, who now have to pay Social Security payroll taxes on their contributions.

Almost as important to employers as the payroll taxes they have to pay is the administrative burden of accounting for the contribution. Consider, for instance, plans covering retired workers. Retired employees now incur a tax liability for contributions made on their behalf by their former employers, who are required to issue W-2 or 1099 forms for them.

So far, few existing plans have been terminated because section 120 expired, but as plans come up for renegotiation in a period of tough global competition, health care cost pressures and static wages, the taxability of legal services plan contributions can only work against them compared to tax-favored benefits.

Section 120's expiration has also deterred additional employers from beginning to offer group legal service benefits, given that other non-taxable benefits are readily available. Where taxable group legal service benefits are offered in a flexible benefit plan, they have been in some instances slighted in favor of other non-taxable benefit options.

State income tax ramifications are also important. Many states' personal income tax laws follow federal income tax exclusions. Since section 120 expired, employees in those states effectively have seen an increase in their state income taxes.

Tax Revenue Insignificant

While the current taxability of plan contributions threatens their future, it is producing insignificant tax revenue to the federal government. The Joint Committee on Taxation's latest estimate was that letting Section 120 expire would produce $85 million in revenue, an infinitesimal percentage of the federal budget. Even that estimate is too high, because it ignores shifts in contributions that are already occurring from legal services plans to health benefits and others that remain tax-exempt.

In conclusion, Congress should rescind the back door increase on middle class Americans resulting from the expiration of Section 120 and reinstate the Congressional policy of encouraging private efforts to achieve justice more efficiently for the average citizen.

The Louise and Claude Rosenberg, Jr. Family Foundation

Phillip D. Moseley, Chief of Staff, Committee on Ways and Means

Reference: Statements re Gifts of Publicly-Traded Stock to Private Foundations

My name is Claude Rosenberg, Jr., and I am writing on behalf of myself and my wife, Louise J. Rosenberg. I am a registered Investment Advisor, founder of RCM Capital Management of San Francisco, California, managers of (mainly) institutional monies of over $20 billion invested in common stocks and bonds. I have over forty years of experience in the investment field, have authored four books on investing, and am the author of a well-accepted book on philanthropy, entitled *Wealthy and Wise: How You and America Can Get the Most Out of Your Giving* (Little, Brown & Co., published October, 1994). My wife and I are strongly-committed advocates of, and participants in, philanthropy through both personal contributions and involvements and through a private foundation, The Louise and Claude Rosenberg Family Foundation, which we formed December 23, 1986. It is important to state that we plan to continue supplementing our foundation giving through significant personal charitable contributions, and that we would benefit from the deductibility from the use of appreciated securities--hence, the recommendations made herein would be costly to us personally.

While we favor the *general* use of readily marketable stock at full market value as tax-deductible contributions to private nonoperating foundations, we believe that new regulations that will ensure enhanced use of such funds to worthwhile causes should accompany a restitution of full market value benefits to contributors. Our position, described specifically below, is motivated by the following: a) that serious social ills permeate our nation; b) that a significant decline in funds to certain social needs will occur in our (proper) quest for the elimination of waste from government expenditures; c) that transfer of funds from Federal to state governments, while preferable, will not provide the necessary solutions to our social problems; d) that the private sector can accomplish "more with less" than the public sector in many endeavors now dominated by government; and e) that enhanced philanthropic contributions, combined with the amazing volunteer force already serving the nonprofit sector, constitutes the most efficient and most desireable way to alleviate, and in many cases eliminate, many of our nation's worst social problems.

Despite these facts and this reasoning, we contend that allowing private nonoperating foundations to be bolstered anew through *the use of fully deductible gifts at market price would be shortsighted without encouraging greater and more imminent use of such funds than the current mandated five percent (pre-operating and related expenses) of corpus rule.* **The five percent payout may give our government(s) a fair return when donations are made in cash, but the costs to government(s) from allowing the avoidance of capital gain taxes along with a five percent payout seem less fair. This is especially important to consider because of America's serious deficits (Federal, along with many states and local communities), as well as the existence of the**

aforementioned debilitating social conditions of our nation. *In short, our government should become more certain that more critical improvements to our society result from private foundation efforts than has been the case. Our government should encourage a new wave of responsible philanthropy that should favorably alter charitable donations and lead to a highly positve trend for volunteerism, as well as an enhanced spirit of cooperation amongst our citizenry.*

Our proposed rules are divided into two parts: first, pertaining to **new contributions to private foundations**; and second, to **existing money within such entities.**:

New Contributions to Private Foundations: Tax deductibility of donations should be tied to two factors: first, to the amount of capital appreciation (market value versus original cost) of the donated asset; and second, to the subsequent payout ratio to be made by the donor's foundation from such asset. The higher the percentage of market value over cost, the higher the required subsequent donation payout ratio (and vice versa). Thus, a donated common stock that carries a 99 percent gain over its cost would receive little or no deductibility under a 5 percent payout plan, but it would receive full deductibility if it were segregated into a new entity within the recipient private foundation and become committed to, say, a 50 percent payout. Likewise, a donated stock with a 50 percent gain over its cost might require perhaps a 25 percent annual payout to receive its full deductibility as a gift.

This suggestion should be considered as a temporary encouragement for more money to flow to the private sector at this particular time. As our country's social and financial conditions improve, it would be hoped that terms would become more favorable for giving, with less restrictions on the use of appreciated securities. **Still, the concept of relating tax deductibility to the amount of appreciation of assets donated, along with donor choice of payout ratio, seems valid and eminently fair to all parties.**

Existing Money in Private Foundations. Legislators must be careful not to tamper unnecessarily with the five percent payout mandated from private foundation *existing assets*. Protection of purchasing power (being hedged against inflation) is important for foundations as it is for individuals. Despite this warning, study should be made to determine whether increased payouts *from existing assets* can be encouraged in the event of significant (well above average) asset growth within private foundation portfolios. Foundation personnel, including original donors, should not lose sight of the principal missions of their institutions: To provide opportunity for those to which opportunity is not readily available; To foster greater accomplishments from the private sector; To benefit America through its unique system of free enterprise supplemented by associations of private citizens willing to cooperate and make reasonable sacrifices for the good of the whole.

Thank you for your consideration of these recommendations. Respectfully submitted,

Claude Rosenberg, Jr. Louise J. Rosenberg

The Louise and Claude Rosenberg, Jr. Family Foundation

Supplemental Sheet to statements made by Louise J. Rosenberg and Claude Rosenberg, Jr. in letter to Phillip D. Mosely, Chief of Staff, Committee on Way and Means, on May 20, 1995, subject "Statements re Gifts of Publicly-Traded Stock to Private Foundations."

1. Writers of the above document, Louise J. Rosenberg and Claude Rosenberg, Jr., can be reached at:

2465 Pacific Avenue, San Francisco, CA 94115
Home phone: 1 415 563 8444
Office phone: 1 415 954 5441; Fax: 1 415 954 8201

2. Summary of comments and recommendations:

While we favor the *general* use of readily marketable stock at full market value as tax-deductible contributions to private nonoperating foundations, we believe that new regulations that will ensure enhanced use of such funds to worthwhile causes should accompany a restitution of full market value benefits to contributors.

We contend that allowing private nonoperating foundations to be bolstered anew through *the use of fully deductible gifts at market price would be shortsighted without encouraging greater and more imminent use of such funds than the current mandated five percent (pre-operating and related expenses) of corpus rule.* **The five percent payout may give our government(s) a fair return when donations are made in cash, but the costs to government(s) from allowing the avoidance of capital gain taxes along with a five percent payout seem less fair. This is especially important to consider because of America's serious deficits (Federal, along with many states and local communities), as well as the existence of the present debilitating social conditions of our nation.** *In short, our government should become more certain that more critical improvements to our society result from private foundation efforts than has been the case. Our government should encourage a new wave of responsible philanthropy that should favorably alter charitable donations and lead to a highly positve trend for volunteerism, as well as an enhanced spirit of cooperation amongst our citizenry.*

Our proposed rules are divided into two parts: first, pertaining to **new contributions to private foundations**; and second, to **existing money within such entities.**:

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percent gain over its cost might require perhaps a 25 percent annual payout to receive its full deductibility as a gift.

This suggestion should be considered as a temporary encouragement for more money to flow to the private sector at this particular time. As our country's social and financial conditions improve, it would be hoped that terms would become more favorable for giving, with less restrictions on the use of appreciated securities. **Still, the concept of relating tax deductibility to the amount of appreciation of assets donated, along with donor choice of payout ratio, seems valid and eminently fair to all parties.**

Existing Money in Private Foundations. Legislators must be careful not to tamper unnecessarily with the five percent payout mandated from private foundation *existing assets*. Protection of purchasing power (being hedged against inflation) is important for foundations as it is for individuals. Despite this warning, study should be made to determine whether increased payouts *from existing assets* can be encouraged in the event of significant (well above average) asset growth within private foundation portfolios.

Respecfully submitted,

Louise J. Rosenberg Claude Rosenberg, Jr.

TESTIMONY OF JACKIE R. MCCLAIN
EXECUTIVE DIRECTOR OF HUMAN RESOURCES, AFFIRMATIVE ACTION, THE UNIVERSITY OF MICHIGAN

AT A HEARING OF THE SUBCOMMITTEE ON OVERSIGHT,
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

Thank you Mr. Chairman and members of the sub-committee for allowing me this opportuntiy to provide this statement for the record:

I have the privilege of serving as the Executive Director of Human Resources and Affirmative Action at the University of Michigan at which some 26,000 faculty and staff provide services to 47,900 students in 20 schools and colleges. In this capacity, I am acutely aware of the critical need for the enactment of legislation which would make the exclusion for employer provided education assistance (Section 127) a permanent part of the Internal Revenue code.

As you know, Section 127 permits employees to receive up to $5,250 annually in tuition reimbursement from their employers on a tax-free basis. One essential aspect of this provision is that it applies to both undergraduate and graduate education. Such assistance enhances job satisfaction and encourages continual upgrading of skills and knowledge. Such assistance may be the only realistic means of seeking such educational opportunities for many employees of the University of Michigan.

Since 1990, between 1200 and 2300 University of Michigan staff members have annually utilized our tuition reimbursement program. The program has cost approximately $500,000 annually but has greatly benefited not only the employees receiving the assistance, but the departments benefiting from their enhanced capabilities. Many employers such as the University of Michigan are willing to provide funding for employees to secure additional education, however, many of the employees who might take advantage of this benefit find the taxation on such benefits to be prohibitive. Therefore, extension of this exclusion is critical to their ability to capitolize on the assistance.

In support of the extension I would offer the following statements:

1. **The permanent extension of this exclusion would provide educational assistance benefits to many low and moderate income employees who seek to better themselves.**

Many of our employees have enrolled in area community colleges in order to seek continuing education while working full-time, often with family obligations as well. A 1989 Coopers and Lybrand survey indicates that 71% of the Section 127 beneficiaries earn under $30,000. This would seem consistent with the University of Michigan experience. This tax exclusion is especially important for women and minorities and those in lower paid positions who need improved skills to qualify for increasingly complex and technical jobs. These are often the individuals who have few resources to seek such educational opportunities on their own and for whom even the taxation of the benefit becomes burdensome.

2. **With rapid advances in technology, the need for retraining and re-education of employees to maintain a stable workforce is a critical employer issue.**

Employers throughout the United States are experiencing rapid changes and growth in the use of technology. With the advent of the daily use of computers and specialized computer programming, as well as telecommunications and internet communications, the employees of today requires a skill base which must change frequently to allow them to fully utilize technology in the effective performance of their job.

For such employers, movement toward the use of technology is both cost effective and pro-employee. We have adopted the practice, not of replacing employees who lack technical skills, but of providing employees with the opportunity to obtain such skills.

Employers benefit from a highly skilled, computer literate workforce through increased productivity and enhanced customer service. However, especially among our lower to mid-level employees - who have perhaps the most to gain from continuing education to obtain the necessary technological skills - educational opportunities may be simply out of reach when employer provided or subsidized training is taxable in nature.

3. **The lack of a permanent extension results in uncertainty for both employers and employees and presents numerous problems.**

At the exclusionary limit of $5,250 advanced under this legislation, employees could experience the added cost of approximately $1000 to $2000 in

their tax bill. Faced with the uncertainty of whether educational assistance accepted in the near term might vary in cost to this degree, many employees will likely choose to act conservatively and either eliminate or reduce the educational assistance they accept.

Further, the uncertainty and confusion surrounding the actual employee cost of employer provided educational assisstance undermines what I believe is widely considered a valuable employee benefit. As a Human Resources professional, and more particularly, as a Human Resources professional at an institution of higher learning, I believe this confusion sends employees precisely the wrong message about the importance and value of continuing education.

One only needs to look to the legislative history of Section 127 to understand the reason for current uncertainty. Since the Revenue Act of 1978, Congress has legislated five extensions of Section 127, but each time only temporarily. Repeatedly, the Section has lapsed, and then been reinstated retroactively. The permanent extension of this provision would achieve what has repeatedly been the will of congress, while reducing educational planning uncertainties for employees and administrative difficulties for employers.

STATEMENT
BY
CONGRESSMAN JOE MOAKLEY
ON H.R. 540, LEGISLATION TO RESTORE
SECTION 120 OF THE INTERNAL REVENUE CODE

Madam Chairperson and Members of the Subcommittee, thank you for holding this hearing on legislation to restore Section 120 of the Internal Revenue Code. I am a strong supporter of H.R. 540 and urge the Members of this subcommittee to report this measure favorably.

Section 120 of the Internal Revenue Code was first enacted in 1976 and it was so successful that Congress renewed it seven times. It encourages employers to pay for preventive legal services for employees and their families by excluding from their income the first $70 per year contributed to a qualified legal service plan.

Employer-financed group legal service plans have become a safety net for more than 2.5 million Americans. Members of the plan are able to gain access to affordable and qualified legal representation to settle disputes. In many instances, members are able to avoid personal disasters, like losing a family home, declaring bankruptcy due to insurmountable debt problems, or losing custody of a child.

In Massachusetts, section 120 has benefitted more than 120,000 members and their families. These people are not wealthy, they are hard working, tax paying, middle class Americans. They are teachers, policemen, firemen, waiters, government workers, electricians, carpenters and autoworkers.

Not only does Section 120 benefit employees but it is good for businesses. Because employees are able to contact lawyers upon learning of the problem, they are able to resolve them quickly and avoid costly litigation. Thus, employees are much more productive at work because they are not distracted by legal problems.

There is no organized opposition to group legal services plan. It enjoys the broad bi-partisan support of labor, consumer, bar, and insurance groups. These plans are a sensible approach to help people avoid costly, and disastrous legal problems.

I urge my colleagues to reinstate section 120 of the Internal Revenue Code. It benefits hard-working middle class Americans before it is to late.

STATEMENT OF MARY KELLER, VICE PRESIDENT

MORGAN GUARANTY TRUST COMPANY OF NEW YORK

Oversight Subcommittee

Committee on Ways & Means

United States House of Representatives

May 9, 1995

On behalf of the Morgan companies, including Morgan Guaranty Trust Company of New York, one of America's leading financial institutions, I congratulate and thank the Committee on Ways & Means for considering reinstatement of Section 127 of the Internal Revenue Code, the income exclusion for employer-provided educational assistance, and urge prompt approval of legislation that would restore Section 127. We also thank Congressmen Levin, Shaw, Camp, and Rangel -- and the many other members of this House who have worked to secure permanent reinstatement of Section 127.

This statement is submitted for the record of the Oversight Subcommittee's hearings concerning various expired provisions of the Internal Revenue Code, and we ask that a copy of this statement be made part of the record.

Morgan has long advocated a permanent extension of Section 127. In 1988, we testified before the Senate Finance Committee in support of legislation to restore Section 127 and make it a permanent part of the tax code -- and we have previously submitted statements in support of the program. During this time, Section 127 has survived on temporary extensions alone, some lasting only a matter of months. These temporary extensions were surely to be preferred to the alternative of letting the program die -- but they have worked a hardship on employees trying to plan for their education. We are hopeful, therefore, that these hearings will result in permanent reinstatement of Section 127 -- or, failing that, long-term extension of the program.

We believe in tuition assistance. Morgan provides hundreds of thousands of dollars in tuition assistance to its employees each year. We believe that the Morgan program is typical of the educational assistance programs offered by other major corporations and financial institutions. Our program is open to any full-time employee with at least six months service. We provide reimbursement for approved courses leading to undergraduate or graduate degrees and job-related certificates. Employees must receive a grade of "C" or better (or "Pass" in a "Pass/Fail" course) to qualify for reimbursement. Our employees have been enrolled in courses at private and public colleges and universities and have participated in special certificate programs at institutions like the American Institute of Banking, the educational affiliate of the American Bankers Association.

Our own experience supports the numerous studies that have found that Section 127 primarily benefitted low and moderate income employees. This year, much attention has

been given to the merits of a middle class tax cut. Without Section 127, middle class employees receiving educational assistance from their employers actually face the prospect of a tax *increase* -- an increase that they can only avoid by giving up tuition assistance. In short, employees will be penalized for pursuing their education. As we look for ways to encourage employees to pursue training opportunities, this simply makes no sense.

Some people are concerned by the alleged costs of this program. We believe that these concerns are misplaced. First, since Section 127 was part of the tax code for roughly 17 years, those who advocate its termination are looking for ways to raise money -- not save money -- by imposing a new tax on the middle class. Second, and more important, we believe -- and have always believed -- that Section 127 pays for itself.

A few simple illustrations -- based on our own experience -- should make this clear. At Morgan, a secretary who obtained her undergraduate degree through the tuition program subsequently became an assistant vice-president of the bank, making twice the salary she would have made in her secretarial position. A messenger who joined the program after joining the office staff was appointed an officer soon after obtaining his degree, earning nearly twice the salary he would have earned in a normal clerical career path. A former mail clerk who worked his way through the ranks and obtained an undergraduate degree in business administration later earned in excess of $100,000 as a vice-president of the bank.

These are admittedly dramatic success stories -- but they are real. In 1992 we reviewed a random sampling of employees who participated in the Morgan tuition assistance program in 1987. We found that -- between 1987 and 1991 -- salaries for several of the employees had increased by more than 40% -- with some increases ranging as high as 106%. These salary increases are well in excess of adjustments accounted for by inflation or customary step-increases. Although we have not conducted a current survey, we know of numerous employees who were hired in clerical or administrative positions, participated in the tuition assistance program, and now hold professional positions. Some are officers of the bank.

It should be self-evident that these employees have paid and continue to pay taxes well in excess of the tax revenues foregone by allowing them to receive their tuition payments tax-free. Reviewing the individual tax liability of a typical employee who obtained a college degree through a tuition assistance program, we believe that -- over a five year period -- the Federal government would realize a 900% gross return on its initial tax "investment."*

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* In 1988 we reviewed the hypothetical example of a clerical employee earning between $20,000 and $24,000 during five years in which she pursued an undergraduate diploma with assistance from the bank. We assumed that the employee obtained an undergraduate degree, and -- five years later -- earned $55,000. Assuming no dependents or other income, and taking only the standard deduction, we calculated that this employee would have paid about $13,500 in taxes in 1987 alone -- almost $9,000 more than the taxes she would have paid if she had remained in a clerical track and were earning $29,000. Assuming further that this employee had received $1,800 in tuition assistance in each of the years that she was in college, the total tax foregone while she was in school would have amounted to $3,090 -- only one-third of the total increased tax which the employee later paid in a single year. Using reasonable assumptions, we calculated that -- over the five year period following her education -- the Federal government realized a 900% return on its initial tax investment, a total of $28,000 in additional taxes. Even factoring in a reasonable interest rate on the foregone revenues, the return on investment would have exceeded

Admittedly, this conclusion is based on a rough cut analysis. Nevertheless, we believe it is fair to assume that -- for most workers -- the increased training made possible by Section 127 translates into higher income -- and higher taxes. Without Section 127, it is fair to assume that many employees will abandon or cut back on their educational plans. To the extent that workers abandon their education the government will not realize any increased tax revenues whatsoever.

Of course, the purpose of providing educational assistance is not to generate tax revenues. The purpose of educational assistance is to enhance the skills of the workforce. An educated workforce is a more productive workforce. Increased productivity makes American businesses more competitive worldwide. And, while increased revenues to American business also mean more tax revenues for the government, they also provide new jobs and strengthen the American economy. Without Section 127, the opportunity to enhance the competitive skills of the workforce through tuition assistance programs may be lost or, at best, delayed.

Another compelling reason to retain Section 127 is the role that it plays in helping minorities and women who want to continue their education but cannot afford to do so on their own. Morgan is deeply committed to equal employment opportunity -- and our tuition refund program is an integral part of our efforts to attract and keep minorities and women. Our program is open to anyone who meets the program's criteria and is willing to do the work. Women have historically accounted for nearly 80% of the employees participating in our program -- and better than 50% of the participants have been members of racial and ethnic minority groups. These employees, by their participation in the tuition assistance program, have demonstrated the will to succeed despite financial obstacles. For them, employer-provided educational assistance is not a "fringe" benefit or a "frill." It is, instead, critical to their continued pursuit of their educational objectives. These employees are going to school at night and on weekends. They work hard at their education. They deserve our support.

Without any government bureaucracy, and with minimal paperwork, Section 127 has helped hundreds of our employees to obtain college and graduate diplomas. In 1994, our employees were enrolled in undergraduate programs in 49 colleges and universities in New York and New Jersey, ranging from small community colleges to nationally recognized universities like Fordham, Hofstra, and Rutgers. (A list of these schools is attached.) It is one of the true success stories in the tax code -- and it pays for itself many times over its costs. When the Senate Finance Committee approved Section 127 in 1978, the Committee observed that the then-current practice of taxing tuition payments worked as a "disincentive to upward mobility." That concern is no less valid today. Simply stated, there is no good reason to tax employees for pursuing their education -- and many good reasons not to. If this nation is to maintain a workforce capable of competing in an increasingly competitive world economy, we must retain Section 127.

We thank you for this opportunity to express our views.

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*(...continued)
500%. Of course, the increased tax revenues would be likely to continue year to year over the taxpayer's lifetime.

UNDERGRADUATE COLLEGES AND UNIVERSITIES
ATTENDED BY MORGAN EMPLOYEES PARTICIPATING IN THE
TUITION REIMBURSEMENT PROGRAM
1994

American Institute of Banking
Audrey Cohen College
Baruch College
Berkeley School
Bloomfield College
Borough of Manhattan Community College
Brookdale Community College
Brooklyn College
City College
College of New Rochelle
College of Staten Island
Dominican College
Fashion Institute of Technology
Fordham University
Georgian Court College
Heald Business College
Hofstra University
Hudson County Community College
Hunter College
Iona College
Jersey City State College
John Jay College of Criminal Justice
Kean College
Kingsborough Community College
LaGuardia Community College
Lehman College
Marymount College
Marymount Manhattan College
Medgar Evers College
Molloy College
Montclair State College
Nassau Community College
New York University
NY Institute of Technology
NYC Technical College
NYU School of Continuing Education
Ocean County College
Pace University
Queens College
Rutgers University
School of Visual Arts
St. Francis' College
St. John's College
St. Peter's College
SUNY Farmingdale
Westchester Community College
William Paterson College
York College

STATEMENT OF GERALD MANN, ADMINISTRATOR AND CHIEF COUNSEL, DISTRICT COUNCIL 37, MUNICIPAL EMPLOYEES LEGAL SERVICES PLAN

Mr. Chairman and Members of the Committee, my name is Gerald Mann and I am submitting this statement as Administrator of the District Council 37 Municipal Employees Legal Services Plan, a prepaid legal services plan for the approximately 130,000 employees of New York City and related agencies who are represented in collective bargaining by District Council 37 of the American Federation of State, County and Municipal Employees, AFL-CIO. I am also here today on behalf of the National Resources Center for Consumers of Legal Services, the American Prepaid Legal Services Institute, and others.

My comments concern Section 120 of the Internal Revenue Code which expired on June 30, 1992 and which is the subject of H.R. 540, introduced by Representative Rangel, now pending before your committee. Section 120 determines the tax treatment of qualified group legal service plans. It provides that contributions made by an employer to and the value of any legal services received by the employee under such a plan can be excluded from the employee's taxable income.

Section 120 has been extended by Congress seven times in 1981, 1984, 1986, 1988, 1989, 1990, and 1991. H.R. 540 proposes that Section 120 be made a permanent provision of the tax code.

The record of seven Congressional extensions following intensive legislative review, suggests that Section 120 has stood the test of time as good public policy. Our discussion over the years with members of Congress indicate that there is virtually no substantive opposition to the idea of encouraging employers to provide legal services benefits in the same manner as they provide health care and other benefit programs designed to assist employees and their families.

There is no question about the need for making basic personal legal services available to moderate income families at reasonable cost. Clearly, the average family cannot afford the high cost of personal legal services. This problem has been documented in the American Bar Associations landmark study of the legal needs of the low and moderate income public. These figures tell us that about 50 percent of us will encounter a problem in the next twelve months which a lawyer could help resolve, yet only 21 percent of low income households will actually obtain legal services.

The growth of prepaid legal services and the recognition of its value by both labor unions and employers indicate that it is the innovative legal services delivery system which could surmount current income barriers and provide access to justice for the moderate income American.

The rationale for legal services as a benefit for employees is much the same as that for medical and other insurance benefits: to assure the personal well-being of employees and their families so that they can continue to be permanent and productive members of the work force. Legal plans offer employees preventive legal care -- preventing a minor problem from becoming a major legal entanglement through early treatment.

For some -- too poor to afford private legal assistance, yet employed and earning just enough to make them ineligible for government-financed legal aid -- lack of access to legal services is not just an inconvenience. It can be a matter of survival. For many low and moderate income working Americans, current economic conditions have increased their need for legal help in regard to potentially devastating personal problems such as child support enforcement, housing, evictions, consumer debt, divorce and custody, and child abuse.

At the legal services plan office in New York, we often see clients with multiple problems. A serious unresolved legal problem tends to create a domino effect on the life of a moderate income family. A debt problem can lead to a garnished salary, eviction, disintegration of the family unit, and in some cases, even loss of a job, dependency on public assistance and homelessness. The relatively small cost of the legal services plan is repaid many times by keeping the family intact and self-sufficient.

Of the approximately 10,000 new cases our office handles each year, almost 3,000 involve consumer problems and debt, 2,000 cases involve a landlord seeking to evict our workers and 3,000 matters involve family problems, such as enforcement of child support, divorce, adoptions, family violence and abuse and neglect of children.

Today's economic uncertainties and the realistic fear of loss of a job has had a devastating effect on family relationships. Incidents of family violence have increased as has child abuse and neglect.

Working grandparents have had to assume the burden of raising and supporting young children because a generation of parents have been incapacitated by drug and alcohol abuse. In all of this, a lawyer's intervention is necessary to assist in maintaining what remains of the family structure.

We represented a 43-year-old woman who works for New York City's Department of Social Services as a computer operator. Her husband, who began to physically abuse our client had left the home. Our client is now the sole support of two children, ages 7 and 12. Family emergencies had caused her to fall behind in rent payment and she now faces eviction proceedings.

She worried constantly about the effect of neighborhood drug traffic and violence upon her children. During one office visit, she began crying and was unable to stop. She threatened suicide, and had to be taken to a hospital's psychiatric department by the emergency medical service. The legal service we provided enabled her to avoid eviction, file for divorce, obtain child support and be placed in an outpatient counselling program.

I am able to report the she remains gainfully employed and is now capable of maintaining her family unit.

These New York City public employees, all working people of modest means, would not have been able to afford legal services from the private bar. The consequences of their not having access to a lawyer would have been severe.

Employer-paid group legal benefits plans make legal representation available to participants at a fraction of what medical and other benefit plans cost. By placing legal services on the same tax footing as other more expensive statutory benefits, Section 120 has encouraged employers to look to group legal benefits plans as an inexpensive way to enhance real employee compensation.

When our low income members and fixed income retirees received their 1994 W-2 forms requiring payment of income tax on the cost of their legal services coverage, they were outraged. To many of our members, the additional tax burden is a real economic hardship. It is difficult for them to understand why Congress has elected to single out this needed protection for inequitable treatment.

Legal plans have become an important consideration in employers' desires to provide fringe benefits which contribute to employee well-being while keeping costs under control. While the cost of health insurance benefits have tripled over the last 165 years, the cost of the legal service benefit plan I am familiar with have risen less than 40 percent over the last 15 years, or about 2.6 percent per year.

We urge Congress to finally resolve the issue of permanence for Section 120 and the other tax provisions expiring this year. The lack of an exemption has inhibited the adoption of legal plans by employers because of unpredictable tax consequences.

The time has come to make Section 120 permanent. Qualified group legal plans, which millions of working Americans depend on for basic legal advice, will be in serious jeopardy if Congress fails to renew Section 120. The provision's demise has already caused the termination of a number of legal benefits plans.

On the other hand, the cost of the Treasury of a permanent Section 120 is minuscule, if any. In today's world of scarce pre-tax benefit dollars, employers, instead may shift the amount of the contribution to other forms of tax-free statutory benefits.

What then would be the real results of the provision's permanent demise:

- The elimination of a valuable employee benefit for a major portion of the 2.75 million employees, plus members of their families, who are now covered;
- The loss of tax dollars that can be saved by reductions in the use of our courts to resolve minor disputes as a result of preventive legal services available to employees through qualified group legal service plans; and
- Decreased productivity in the workplace due to an increase in employee personal and legal problems.

In these difficult economic times, many middle class working Americans express little confidence that our political and legal institutions represent their interests. Working people will view a Congressional decision to abandon their employer-provided legal benefits as yet another example of a hit on the middle class. Further, the contention that our legal system exists only for the wealthy will be reinforced.

We now ask that Congress acknowledge its wisdom in having created Section 120 and having sustained its existence for 16 years by passing legislation which would make this provision a permanent part of our tax laws. H.R. 540 would accomplish this goal and we urge its adoption.

NATIONAL ASSOCIATION OF COLLEGE AND UNIVERSITY BUSINESS OFFICERS

Written Testimony of
Mr. Ralph H. Beaudoin
Vice President for Finance and Treasurer
The Catholic University of America
for the Record of the Hearing on

Section 127 of the Internal Revenue Code

Subcommittee on Oversight
of the Committee on Ways and Means
U.S. House of Representatives
Tuesday, May 9, 1995

The following associations join NACUBO in this statement:

American Association of Community Colleges
American Association of State Colleges and Universities
American Association of University Professors
American Council on Education
Association of American Medical Colleges
Association of American Universities
Association of Community College Trustees
College and University Personnel Association
Council of Graduate Schools
National Association for Equal Opportunity in Higher Education
National Association of Graduate-Professional Students, Inc.
National Association of Independent Colleges and Universities
National Association of State Universities and Land-Grant Colleges
National Association of Student Financial Aid Administrators
National University Continuing Education Association
United Negro College Fund

NATIONAL ASSOCIATION OF COLLEGE AND UNIVERSITY BUSINESS OFFICERS

Written Testimony of

Mr. Ralph H. Beaudoin
Vice President for Finance and Treasurer
The Catholic University of America

I commend the Subcommittee on Oversight of the Committee on Ways and Means for holding timely hearings to examine issues related to recently expired tax provisions and look forward to exploring with you in detail the importance of tax provisions that strengthen our work force and the nation's competitiveness in the world economy.

On behalf of the National Association of College and University Business Officers (NACUBO), I would like to express support for H.R. 127, legislation that would permanently reinstate Section 127–*Employer-Provided Educational Assistance* of the Internal Revenue Code which expired December 31, 1994. NACUBO is a membership organization representing chief financial officers, as well as business managers and administrators, at more than 2,100 of the nation's colleges and universities. The association is dedicated to promoting sound fiscal and administrative management of higher education institutions. The higher education associations listed above join NACUBO in this statement.

Since its enactment in 1978, Section 127 has provided needed and important tax relief to the many thousands of workers who have benefited from receiving educational assistance from their employers. It is in the nation's best interest to reinstate this provision of the tax law and make it permanent. A continuation of this form of tax relief is important for the following reasons:

- Section 127 makes education affordable for members of the work force who might otherwise be unable to attain additional training or higher education.

- Section 127 allows workers at all levels, but most importantly, at low-and-moderate income levels, to receive education to enhance their skills, retrain to prepare for new or modified jobs based on technological change, and prepare for new occupations.

- Section 127 encourages employees to attain advanced skills and education.

- Section 127 encourages employers in all sectors–public and private, profit and nonprofit–to provide educational assistance to their employees and promote the acquisition of new and higher skills in the work force.

Section 127 encourages employers to provide educational and training programs to their employees. In particular, low-wage and low-skilled employees have been supported in their efforts to seek specialized education necessary for job advancement, and employers have been encouraged to promote training and increase the technological sophistication of their work forces.

Section 127 has played a major role in providing opportunity, support, and access to millions of working Americans in obtaining education and training that is vital to the economic competitiveness of our country. Now, more than ever before, this provision is an important component of a national commitment to work force training. Section 127 is one very important way to provide encouragement for working Americans who seek to improve their skills. The provision also exemplifies good public policy by helping the individual and also contributing to upgrading the nation's work force and maintaining our competitiveness.

Today, the world's economy depends upon communications and information as competitive tools. The race to obtain information drives the technologies necessary to produce it. Knowledge grows and new opportunities present themselves. This rapidly increasing pace of technological advancement on a world-wide basis requires that America's

work force have access to new knowledge through continuing training and education. Only then can we take full advantage of the opportunities.

Rapid technological change also presents new ethical issues for our society. Medical breakthroughs in genetic engineering, transplants, life sustaining machines, and *in vitro* fertilization are but a few of the areas of ethical concern. More education in the liberal arts and in particular, ethics will be necessary for our society to face the social and ethical questions that technological breakthroughs are posing and will continue to pose.

Continual changes in our nation's economy and world markets lead to the displacement of American workers. We can expect to be displaced *at least twice* (and many futurists indicate many Americans will change their careers as many as seven or eight times) during our work life. We can no longer count on permanent employment with a single employer. Even corporations best known for long-term commitments to their employees such as IBM and AT&T have had to abandon these long-standing traditions. Americans need the opportunity to improve and update their knowledge in order to maintain their contributions to our society and our economic way of life.

It is not surprising that adult students returning to school to obtain undergraduate and graduate education represent the largest growing sector of the nation's student body. Global competitiveness is very much felt at the personal level and Americans are responding in record numbers by increasing their knowledge and skills through education. As a society, we need to encourage their effort by providing access and encouragement through measures like Section 127.

As we approach the 21st century, more of the "hired hands" will be replaced by the "hired minds." American brain power will be necessary to maintain the country's competitive position and safeguard its way of life. The developed intellect is the vital capital needed to solve the problems we face now and will meet in the future. Section 127 is one way to contribute to the formation of our country's intellectual capital.

On behalf of NACUBO and the other organizations that join in this testimony, we urge you to support H.R. 127, a bill that will make this important provision a permanent part of the Internal Revenue Code.

We are grateful to the Committee for this opportunity to express our interest and concern.

Statement of
Sanford T. Rosenthal, EA
National Association of Enrolled Agents

Oversight Subcommittee
Committee on Ways and Means
U.S. House of Representatives

On behalf of the National Association of Enrolled Agents, I wish to submit this statement for the record.

NAEA appreciates the opportunity to present this statement on behalf of its approximately 9,000 Enrolled Agent members and to speak for the individual and business taxpayers whom we represent. Enrolled Agents are professional individuals whose primary expertise is in the field of taxation and taxpayer representation. As the Sub-Committee members well know, the Enrolled Agent profession was created by an Act of Congress in 1884 to provide for competent and ethical representation of claimants before the Treasury. We are proud to say we have been diligently fulfilling our responsibilities for the past 111 years.

Enrolled Agents establish their expertise in taxation and taxpayer representation by either passing the Internal Revenue Service's comprehensive two-day examination on federal taxation or by serving as an IRS employee in an appropriate job classification for at least five years. NAEA Members maintain their expertise by completing at least 30 hours of continuing professional education each year. Our Members work with more than four million (4,000,000) individual and business taxpayers annually.

It is in our role as the voice for our Members and for the general taxpaying public that NAEA submits this statement for the record on certain expired and expiring tax provisions.

I would like first to thank the Ways and Means Committee for its prompt action in extending and making permanent the deduction for medical insurance premiums for the self-employed. This is critically important for the many small businesses with which Enrolled Agents typically work. While I understand that revenue constraints limited the amount deductible to 25% in 1994 and 30% for the following years, I would ask that you consider revisiting this issue again. This is a priority for all small business owners, and for reasons of fairness and equity with other forms of businesses, the amount deductible by the sole proprietors should eventually be increased to one hundred percent (100%).

Benefit to Small Business and the Nation's Economy by Permanent Extension of Expired and Expiring Tax Provisions

These provisions include the targeted jobs tax credit, the exclusion for employee educational assistance, and the tax credit for research and experimentation. Each of these provisions offers employers and employees the ability to "bootstrap" to higher levels of productivity, with subsequent increased income, and eventual permanent increases in income tax revenue resulting from the higher incomes.

Targeted Jobs Tax Credit

This tax credit provides incentives to employers to hire individuals who might otherwise have a difficult time finding employment. The benefit to the employee is eventual self-sufficiency and self-esteem. Society benefits by the employment of marginalized workers who, by being brought into the workforce, can support themselves and their families.

The targeted groups might be periodically modified as social and economic changes warrant. For example, in times of high unemployment, those who have been unemployed for more than one year should be included as a targeted group. Maimonides said hundreds of years ago that "it's better to teach a man to fish than to give him fish". It's a better use of scarce resources to

provide incentives to employers to reach those who are out of the work force. Reinstatement and extension of the targeted jobs tax credit is particularly timely in light of calls for replacement of welfare with work. In view of the benefit to individuals, families and society, it is recommended that the targeted jobs tax credit be reinstated and made a permanent part of the tax code.

Employee Educational Assistance

Employee educational assistance enables workers to obtain non-job related education which will increase their productivity, and benefit both themselves and their employers. It is of particular importance to lower-income workers and to those who are just starting out and who find they need additional education, if they are to move ahead.

According to the well-known Coopers & Lybrand study, "Who Benefits? At What Cost?", the distribution of benefits closely matches earnings among the labor force as a whole. Seventy-one percent (71%) of Section 127 recipients earn less than $30,000 per year and more than one-third (36%) earn less than $20,000 per year. The majority of those using Section 127 benefits are taking business-related courses, followed by courses in engineering, health science/nursing, education and computer science. Less than one-half of one percent are attending professional schools.

The repeated expiration and reinstatement of Section 127 has been very damaging and discouraging to those using employee educational assistance to improve their work skills. Employees are forced to choose between rolling the dice on Congressional reinstatement of this exclusion or having to pay taxes on tuition reimbursement. Many, because of their relatively low incomes, simply drop out of school.

The improvement of the skills of our nation's workforce should be encouraged in every way possible. Employers need to motivate employees to upgrade their skills just as the G.I. Bill motivated our war veterans in years gone by. We believe that this is a cost-effective mechanism, a partnership between employers, employees and the federal government which works very well. Therefore, it is recommended that Section 127 be reinstated and made a permanent part of the tax code.

Tax Credit for Increasing Research Activities

As a California resident, I can attest to the beneficial effect of increased research activities in my state. Many of today's high tech companies started out as small businesses, in some cases they literally began in someone's garage. Research has benefited employers who develop new, improved products that result in more income and profit. Employees benefit by the availability of new jobs. As a nation, we all benefit from maintaining our ability to compete in the global marketplace. This provision also substantially enhances several major tax bills under consideration by Congress.

The R&E tax credit, as the other provisions mentioned before, has suffered from periodic lapses and subsequent reinstatement. It needs to be extended before the June 30 expiration date and made a permanent part of the tax code.

Conclusion

The National Association of Enrolled Agents thanks the Sub-Committee for the opportunity to comment on these provisions. Congresswoman Johnson's efforts in furthering the improvement of the Internal Revenue Code are appreciated by our Members, both as tax professionals and as taxpayers. We stand ready to assist you in this endeavor.

NCSSSA *National Conference of State Social Security Administrators*

May 4, 1995

Phillip D. Mosely, Chief of Staff
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Mosely:

This is in response to the call for written statements for the hearing on several recently expired provisions of the tax laws to be held May 9, 1995 by the Subcommittee on Oversight of the Committee on Ways and Means. The National Conference of State Social Security Administrators wishes to address the exclusion for employer-provided educational assistance.

Let me first provide some background on our organization. The NCSSSA was formed more than 40 years ago and represents more than 70,000 state and local governmental employers across the nation. We have enjoyed an excellent working relationship with the members of both chambers of Congress and their staffs during this time. The NCSSSA also has developed direct lines of communication with the Social Security Administration and the Internal Revenue Service that are used to address the myriad of employment tax and coverage issues governmental officials must face each day.

It is this wide range of coverage and reporting issues that brings us to address the exclusion for employer-provided educational assistance. The rules, regulations and procedures of federal employment taxes, as well as, social security and medicare coverage appear to change almost daily. Today's rapidly evolving technology that is required to withhold, deposit and report employment taxes and to maintain proper social security and medicare coverage on the nation's state and local governmental employees didn't even exist until recent years.

While this speaks only of those state officials involved in employment taxes and social security/medicare coverage, it could well speak for any employer in America. The demand for highly motivated and well educated employees is greater than ever. It is a constant struggle to keep up with the requirements of the workplace and continuing education for employees is a must for any successful enterprise, public or private.

There is a cost to maintain an efficient and well run organization and that cost erodes the profits of private firms and uses much needed tax dollars for public agencies. The provision excluding employer-provided educational assistance is a simple, cost-efficient tool that benefits both the employee and the employer. One should remember the adage, "Knowledge is the only instrument of production that is not subject to diminishing returns."

A well educated, knowledgable work force is vital not only for businesses and public organizations, but for America as a whole. Each individual's life should be a continuing education. Congress has an obligation to encourage, even lead, the nation's work force to better training and higher levels of skill. That is why the NCSSSA believes that, for the good of the nation, the exclusion for employer-provided education assistance should be reinstated.

If you have any questions, please contact me at (502)564-3952 or PO Box 557, Frankfort, Ky 40602-0557.

Sincerely,

Patrick L. Doyle

Patrick L. Doyle, Chair-Person
NCSSSA Legislative Committee

Statement of
William A. Bolger
on behalf of the
National Resource Center for Consumers of Legal Services

The National Resource Center for Consumers of Legal Services strongly supports H.R. 540, which would reinstate the exclusion from employees' taxable income for the first $70 contributed by their employers to qualified group legal services plans under Section 120 of the Internal Revenue Code.

The National Resource Center is a non-profit research and education organization working to improve the legal system. Since our founding in 1972 our primary focus has been on legal services plans because of their potential for encouraging preventive law for the average American.

1. Legal Services Plans Have Proven Their Value.

Plans help families. Legal services plans provide the average American with same access to preventive legal services that wealthy individuals and large businesses have always had. They enable people to avoid legal difficulties and more quickly solve problems that do arise, thus unburdening the court system and keeping employees on the job, undistracted by legal problems. Legal services plans:

>promote family harmony by preventing or resolving serious legal problems

>increase the level of justice by making legal advice more available to the average citizen

>improve economic productivity by keeping employees on the job and focused on their work

>help both the public and private portions of the legal system function more efficiently

Why plans work. Legal services benefit everyone because transaction costs are reduced when advance arrangements are made on a group basis for providing needed legal services. Advance payment is not as important as advance arrangements that make legal services readily available. These advance arrangements dramatically reduce the time, cost and uncertainty involved in selecting and consulting a lawyer when a legal question arises. People covered by a plan contact a lawyer more often, but at an earlier point in the course of a problem. More people receive legal advice, about more matters, but matters are handled at lower cost and in a way that minimizes disputes and litigation.

Legal services plans exhibit considerable diversity in structure, cost and benefits depending on the group of people covered--their number, geographic distribution, family situation, etc.--and the funding available. The plans are privately administered. The lawyers who provide services to plan members are mostly in private practice, and all are subject to state rules of practice. The plans themselves are regulated through ERISA like other employee benefit plans.

Congress was right. In enacting section 120 in 1976 Congress meant to encourage more equal access to legal help for middle income Americans. You succeeded. The Treasury's own June 1988 study of legal services plans found that "plans covered by section 120 did provide relatively greater access to legal services to production workers and union members" (than to professional and administrative employees). "(T) his pattern stands in **stark contrast** to most other kinds of employee benefits, which are relatively less available to production employees." (emphasis added)

Section 120 puts legal services plans on a more equal footing with other statutory fringe benefits. Even the most comprehensive plans seldom cost more than $150 per family per year.

Section 120 was originally enacted as a five-year experiment. Policy makers were concerned about whether the benefit would wind up accruing only to highly-paid executives, whether employer contributions would be insufficient to finance the arrangement and whether inflationary pressures would escalate the cost of legal service plans, as has happened in the case of medical care.

But in considering section 120's fate in 1981, Congress agreed that none of these evils manifested themselves during the five-year trial period. In fact, legal service plans were shown to benefit low and moderate income workers on a non-discriminatory basis. The modest funding formula used to finance these plans not only was shown to provide more than adequate financial support, but costs barely increased during the period. In light of this record, Congress extended the provision for three more years, then extended it five more times for shorter periods.

Even in the face of expirations and retroactive reenactments, section 120 served its purpose. There are now approximately 3.1 million employees and retirees covered by qualified group legal service plans at an average cost of under $100 per worker per year. Since these plans also provide access to essential legal services for family members, a total of 7.6 million Americans now benefit from employer-provided legal services.

Employer-paid legal services plans have so clearly proven their value that almost no one opposes them. Everyone agrees they are a good idea and that they work. The only excuse for letting section 120 expire was that the government needed the $85 million per year attributed to section 120.

2. Letting Section 120 Expire Was An Unfair Tax Increase On The Middle Class.

All employees covered by an employer-paid group legal services plan suffered a tax increase when section 120 expired. So did contributing employers, who now have to pay Social Security payroll taxes on their contributions. Reinstating section 120 would rescind that tax increase.

Almost as important to employers as the payroll taxes they have to pay is the administrative burden of accounting for the contribution. Consider, for instance, plans covering retired workers. Retired employees now incur a tax liability for contributions made on their behalf by their former employers, who are required to issue W-2 or 1099 forms for them.

So far, few existing plans have been terminated because section 120 expired, but as plans come up for renegotiation in a period of tough global competition, health care cost pressures and static wages, the taxability of legal services plan contributions can only work against them compared to tax-favored benefits.

Section 120's expiration has also deterred additional employers from beginning to offer group legal service benefits, given that other non-taxable benefits are readily available. Where taxable group legal service benefits are offered in a flexible benefit plan, they have been in some instances slighted in favor of other non-taxable benefit options.

State income tax ramifications are also important. Many states' personal income tax laws follow federal income tax exclusions. Since section 120 expired, employees in those states effectively have seen an increase in their state income taxes.

Tax revenue insignificant. While the current taxability of plan contributions threatens their future, it is producing insignificant tax revenue to the federal government. The Joint Committee on Taxation's latest estimate was that letting Section 120 expire would produce $85 million in revenue, an infinitesimal percentage of the federal budget. Even that estimate is too high, because it ignores shifts in contributions that are already occurring from legal services plans to health benefits and others that remain tax-exempt.

Congress should rescind the back door increase on middle class Americans resulting from the expiration of Section 120 and reinstate the Congressional policy of encouraging private efforts to achieve justice more efficiently for the average citizen.

3. Legal Services Plans Enjoy Broad Support.

Legal services plans are supported by consumer groups, business, the bar and the labor movement. There is no longer any opposition to them. The few early skeptics have been proven wrong. Bar groups that felt threatened now recognize that plans enable more people to afford timely legal assistance.

A bill identical to H.R. 540 was cosponsored by 220 members of both parties, including both Speaker Gingrich and Subcommittee Chair Nancy Johnson. Legal services plans are not controversial and Section 120 is not costly.

Please restore equal tax treatment for legal services plans by enacting H.R. 540. There is no simpler, cheaper or easier way to make the legal system work better.

Statement
of the
National Society of Professional Engineers
on the
Tax Exclusion of Employer-Provided Educational Assistance

May 24, 1995

The National Society of Professional Engineers supports legislation (H.R. 127) to make permanent the tax exclusion for employer-provided educational assistance (Section 127 of the Internal Revenue Code).

The National Society of Professional Engineers (NSPE) was founded in 1934 and represents over 65,000 engineers in over 500 local chapters and 52 state and territorial societies. NSPE is a broad-based disciplinary society representing all technical disciplines and all areas of engineering practice, including government, industry, education, private practice, and construction.

Section 127 of the Internal Revenue Code allows individuals to exclude from their gross income the value of educational assistance provided by an employer through an employee educational assistance program. The provision is a key plank in our nation's workforce preparation program, benefitting employees of all educational and experience levels. Section 127 plays an important role in assisting engineers in their career-long education. Formal courses are an essential component of an engineer's continuing professional development, particularly given the rapid pace of technological change.

Furthermore, as the nation's industrial and manufacturing base shifts in response to global military and economic changes, there is a need to provide engineers and other highly-skilled worker opportunities to shift with those trends. Most often, these shifts require the acquisition of new knowledge and skills. Tax incentives that encourage employers to incorporate tuition assistance into their continuing education programs are an appropriate response to these challenges facing the engineering profession.

The Section 127 tax incentive provides a mechanism for the government to encourage private sector development of a strong workforce base on which to build future economic stability. Also, the tax incentive relies on existing education and training resources already available, rather than establishing costly, new programs.

NSPE seeks permanent enactment of Section 127 because short-term extensions prevent beneficiaries from making long-range education plans with confidence. In fact, some eligible participants may choose not to avail themselves of the benefit as a result of the uncertainties involved with temporary extension.

Section 127 is a sensible use of tax policy to enhance the preparation of our nation's workforce. It has our full support.

PRE-PAID LEGAL SERVICES, INC.

Representative Nancy L. Johnson
Subcommittee of Oversight, Committee on Ways and Means
U.S. House of Representatives
Washington DC 20515

Dear Representative Johnson:

I am writing to urge your support of H.R. 540 not only because this legislation is personally good for Pre-Paid Legal Services, Inc., a major employer in southern Oklahoma and the only pre-paid legal services company that is publicly held. It is also good for workers in America, more of whom will be able to receive this product as a benefit. Our comprehensive plan of legal benefits for the whole family should be on equal footing with health insurance as a tax deductible expense. Studies have shown that this type of product contributes to employee well-being and productivity. Favorable tax treatment of this benefit certainly needs to be reinstated.

Please add your valuable support to H.R. 540. Let's provide a great value to our work force through this benefit. Working Americans certainly need low-cost legal advice. Group legal service plans should be on equal footing with other statutory fringe benefits.

We appreciate your help and we thank you for the tireless efforts you give for our great country.

Cordially,

Harland C. Stonecipher

Harland C. Stonecipher
Chairman
Chief Executive Officer

STATEMENT
OF
THE HONORABLE CHARLES B. RANGEL
ON THE TARGETED JOBS TAX CREDIT AND EMPLOYER PROVIDED GROUP LEGAL SERVICES
BEFORE THE SUBCOMMITTEE ON OVERSIGHT OF THE COMMITTEE ON WAYS AND MEANS

MAY 9, 1995

Madame Chair I am sorry that I was unable to appear before the Subcommittee in person and so I am submitting this testimony for the record.

I want to indicate my strongest support for the extension of the Targeted Jobs Tax Credit program and the renewal of the exemption from taxation of the value of employer provided group legal services. Both of these programs are important to those in our communities who are less fortunate. One enables many to enter the work force for the first time. The other helps the working person to feel secure in an ever complex society.

TARGETED JOBS TAX CREDIT

I want to join my colleague from New York, Congressman Amo Houghton, in introducing the revised extension of the Targeted Jobs Tax Credit. The changes we are proposing are as a result of the hearings held last Congress where the Committee heard extensive testimony from Secretary of Labor Robert Reich on how the credit needed to be better targeted and designed. It is also a reaction to a compelling need to help people move out of welfare.

One of my biggest concerns about the welfare reform bill that the House has passed is the assumption that so many on welfare and so many fathers of children on welfare are just going to pick themselves up and find a job. Ah, if it was so easy we would not have a welfare problem. We know that most of the people on welfare want to work, but have neither training nor opportunities to secure work. In my district 14 applicants show up for each fast food job opening. Why does the manager have to hire a welfare mother or unemployed youngster when the manager can take on someone older with work experience? We need job training and incentives for employers to encourage them to hire these targeted people.

I have supported the Targeted Jobs Tax Credit since its inception back in 1978. In the last several years it was responsible for helping over 450,000 people per year enter the work force. Many of these people have been on welfare, from families on welfare, or would otherwise be on welfare. Many of those hired have begun successful working careers getting the basic skills necessary to stay in the working world.

In New York City the welfare agencies have turned to America Works, a private organization, to help ready and place welfare mothers in the work force. One of America Works' important tools is the Targeted Jobs Tax Credit. The funds from the credit help influence employers to take on the welfare mother as well as provide some of the operating costs of the America Works training and placement program.

I commend the Targeted Jobs Tax Credit community for working with Congressman Houghton, myself and the Department of Labor to revise the credit to answer many of the issues raised by the Labor's Inspector General and Secretary Reich. The emphasis will now be towards identifying those eligible up front before employment so that we will know that employers are truly targeting instead of just gleaning. The targeting will be directed more closely to those on assistance so that the program's cost will be offset by decreases in various forms of welfare spending. The financial incentives will be focused on retention of employees by increasing the benefit as tenure is extended.

We need to give hope to a generation of families on welfare. The hope of a better future worth working towards. Without it we are compelled to see future generations in the same predicament. Without that hope we are compelled to see more young people in prison and more out of wedlock children. We need to provide incentives to employers to create that hope with a job and a future. The Targeted Jobs Tax Credit is one of the incentives that can help employers do just that.

I am certain that we can create bi-partisan support for the Targeted Jobs Tax Credit. I hope that the Committee will make the extension of the program a very high priority.

I want to thank Chairman Archer and Chairwoman Johnson for allowing the issue of employer provided group legal services to be heard at this hearing. I recognize that in 1993 the exemption of this benefit was not renewed while others were. However, it is still very clear to me that it is important enough to raise again at this hearing on expired provisions.

I have introduced H.R. 540 to extend the exemption from January 1, of this year. Already, this bill has 34 co-sponsors without even a "Dear Colleague" being circulated. I am sure that this bill will be supported by a large bi-patisan proportion of the House.

More than 2.5 million Americans were covered by employer provided legal service benefits. Without the tax exclusion, many employers have considered dropping this benefit and millions of Americans will lose their safety net when they face legal problems. Where programs continue working people are subject to an increase in their tax liability

Group legal service plans insure that participants will get legal counsel before their difficulties become disasters: before houses are lost or tenants are evicted, before cars are seized and utilities disconnected, before divorce or custody proceedings get out of hand. These plans improve productivity by helping employees quickly resolve legal difficulties that otherwise distract them, make them anxious or cause them to lose work time.

During the debate on welfare reform considerable attention was given to the issue of child support. Group legal services allows working mothers to secure legal help to make sure that they can recover child support from an absent father. It is pretty tough to hire an attorney for support orders that might yield a few hundred dollars per month. This benefit makes sure the mother and children keep the lion's share of the award.

Section 120 encourages employees to pay for preventive legal services for employees and their families. This section allows employees to exclude from their income the first $70 contributed by an employer to a qualified legal services plan.

Congress has extended §120 benefits seven times. A Treasury Department report stated that §120 and the group legal services plans they encourage helped middle income workers exactly as intended. Legal services plans have proven their value over the sixteen years that §120 had been in effect. These plans enjoy broad support from consumers, labor, the bar, and insurance companies.

Extension would cost under $100 million annually even assuming that without §120, none of the money now going to qualified legal plans would be diverted to other tax favored benefits.

Legal representation should not be the exclusive privilege of the wealthy. Working class families should have access to legal assistance for their personal problems too.

May 19, 1995

Mr. Phillip D. Moseley
Chief of Staff
Committee on Ways and Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Mr. Moseley:

I am writing to request the permanent extension of the tax exclusion for employer-provided educational assistance, as scheduled for discussion by the Subcommittee on Oversight of the House Ways and Means Committee on May 9, 1995.

As an employee, I have benefited enormously from my employer's education assistance plan. If not for tuition reimbursement, it is doubtful I would have had the financial resources to pursue my undergraduate degree. It was not financially possible for me to have funded my own education. To have waited a year or longer to deduct these expenses from income was not feasible.

In addition, because I was able to apply the tuition reimbursed from one semester of study to the following semester, very little out-of-pocket expense was incurred. And, without the education, it would be very difficult to advance in my chosen profession.

As an employer, I have also benefited greatly from our ability to help employees retain and gain the skills needed to remain successfully employed. As many other employers, we constant update processes to achieve greater efficiency. Many of our employees, who are in the middle-to-low income brackets, advance their skill levels with the help of our education assistance plan. They keep up with new technology and, therefore, continue to add value.

The tax exclusion permits a win-win-win situation for everyone. Our employees win because they achieve personal growth and can derive some comfort from knowing their skills are transferable. The company wins because

educated employees add value and enhance the products and services we provide. And, of course, our shareholders win as we are able to maintain our competitiveness in the marketplace.

The implications are larger than individual companies, too. As employees are trained or retrained by their employers, they gain valuable skills that will permit then to remain gainfully employed members of society. This is particularly important when you consider that the education system in this country is woefully lacking when compared with those of other industrialized nations.

Please continue to exclude from income amounts paid or incurred by an employer for educational assistance provided to an employee under Code Sec. 127, up to $5,250 per individual per year.

Sincerely,

Patricia A. Riccio

Patricia A. Riccio
Employee Benefits Manager

SUBMITTED FOR RECORD ONLY

WRITTEN TESTIMONY OF ROSEBUD SYNCOAL PARTNERSHIP

SUBMITTED TO THE SUBCOMMITTEE ON OVERSIGHT

OF THE COMMITTEE ON WAYS AND MEANS

HEARING DATE MAY 9, 1995

Chairperson Johnson, members of the Committee, Rosebud SynCoal Partnership is pleased to have the opportunity to submit testimony concerning the Production Tax Credit for Nonconventional Fuels (Section 29) and a possible extension of this credit. Rosebud SynCoal strongly supports a continuation of the Section 29 tax credit.

Rosebud SynCoal Partnership (Rosebud) is a general partnership between Scoria, Inc. an indirect subsidiary of Northern States Power Company, and Western SynCoal, a wholly owned subsidiary of Western Energy Company (WECO), an indirect subsidiary of The Montana Power Company. Rosebud owns and operates a 300,000 ton-per-year clean-coal demonstration facility at Colstrip, Montana. The SynCoal® product from that facility is eligible for the Section 29 tax credit.

Rosebud advocates a two-year extension of the "placed in service," "binding contract," and "production" deadlines in Code Section 29(g). Rosebud further believes that such an extension should be limited annually to the first one million tons of solid nonconventional fuels produced and sold from a qualifying facility at any one location and that these tax credits should not be negated by the application of Alternate Minimum Tax. A two-year extension of Section 29 and allowing the credits to offset AMT liability, together with a one (1) million tpy per facility per site cap, would allow companies the opportunity to demonstrate the technical scale-up potential to commercial scale of the involved technologies. This proposed cap is also large enough to allow for the capacity necessary to demonstrate market acceptance of the alternate fuel.

Rosebud believes that Congress created the Section 29 tax credit to recognize and help manage the substantial risk during the precommercial development stages of alternative energy projects. However, once commercialization is achieved the necessity for tax credits diminishes. Our experience and research suggest that nonconventional solid fuels from coal can be competitive with other fuels when those facilities can operate at two to three million tons-per-year of product produced and sold. A two-year extension of Section 29, and allowing the credits to offset AMT liability, together with a one million tpy cap would allow several promising technologies the opportunity to advance to the threshold of economic commercialization and is consistent with the original purposes of the Tax Credit for Nonconventional Fuels.

The federal budget issues currently facing our country make the fiscal impacts of any proposed extension a critical aspect of the legislative process. A limitation based upon facility size efficiently targets the incentive at a level appropriate to support technology development, while preventing abuse of this incentive as a tax shelter. Additionally, this approach leverages the incremental new public investment represented by the incentive against billions of dollars in prior strategic investments which have been made by both the public and private sectors under programs such as the Clean Coal Technology Program.

Rosebud and WECO have a long history in the development of alternative solid fuels. In the late 1960's and early 1970's, WECO conducted research into improving the

quality of low rank coals. Significant technical problems with this early work soon became apparent and WECO was unable to develop the technologies.

By the early 1980's, WECO became aware of a concept advanced by Mountain States Energy (MSE), the company that for many years operated the Department of Energy's (DOE's) Magneto Hydro Dynamics(MHD) research facility in Butte, Montana. WECO and MSE conducted bench tests on a process to remove moisture and sulfur that were promising enough to warrant the construction of a pilot plant. WECO built and operated a 130 lb/hr pilot plant in Butte. Results from the pilot plant led WECO to submit a proposal to the DOE in Round 1 of the Clean Coal Technology Program.

In June of 1990, negotiations between WECO and DOE concluded with the commitment to build and operate a $69 million, 300,000 tpy demonstration project at Colstrip, Montana. WECO then formed a partnership with Northern States Power that led to the formation of Rosebud. Construction began in December of 1990 with the demonstration operational phase beginning in April of 1992. The plant was declared to be in-service in August 1993.

The experience gained from bringing forth a new energy product from the concept stage to the threshold of market acceptance has given WECO and Rosebud valuable perspectives on the evaluation of new technologies. We also have gained an appreciation of the importance and the role of federal tax incentives and the time necessary to develop technology and markets for new products.

New energy technologies must go through several stages of development to prove viability. Bench scale tests of technological concepts must be followed by construction and operation of larger pilot plant facilities which, if successful, are then followed by even larger demonstration phases before commercial operations are possible. Attempts to shortcut these steps lead to unacceptable technical risk and increase the probability of failure. Some companies have attempted to shortcut the development process with devastating results.

Technology development activities require long lead times for planning, permitting, financing, construction and startup. Rosebud's experience has shown that a generous allowance of time is necessary to resolve the many unforeseeable issues that confront all technology developments. For example, Rosebud's demonstration plant took 15 months to shake out after initial startup and no amount of expenditures could have resolved these issues much sooner.

Following a measured development program increases the likelihood of success and mitigates risk. Federal tax credits play a role in the development of new technologies by mitigating market risk and allowing the private sector to fund and develop these technologies.

IRS has complicated Rosebud's developmental activities when they recently withdrew the private letter ruling qualifying Rosebud's current facility and took nearly a year to rule on two private letter ruling requests for the next generation developments. IRS did subsequently issue the requested rulings and has communicated that the withdrawn letter ruling will be reinstated. However, these actions have significantly increased the perceived project risk for next generation developments that are crucial to the ultimate commercialization of these technologies.

The attached development schedule is aggressive and shows why an extension of the inservice date and binding contract dates are necessary for continuing technology development.

Rosebud's plant is now operating at well over design capacity at high availabilities; however, the market has been slow to accept the new product.

Rosebud's experience has shown that once a new technology has successfully made the jump to small scale demonstration, market acceptance is critical to promote the technology's development to a commercial level. Utility and industrial fuel customers are concerned about reliable supply. In our case, their fuel needs are typically severely mismatched with the relatively small production capacity represented by an initial demonstration scale operation, such as our 300,000 tons per year facility.

This mismatch makes long-term commitments from the customers that are needed to support these facilities or next generation facilities nearly impossible because of the perceived physical supply risk being absorbed by the customer. However, without committed customers, these facilities cannot be financed or operated which, in turn, results in stagnation of the technology development. That is why the continuation of the Section 29 tax credits is so important.

If the Section 29 tax credit is extended by the 4th quarter of 1995, Rosebud plans to build two (2) next generation SynCoal production facilities, approximately 500,000 tons per year each. These facilities would allow Rosebud to scale up the technology to a scale of 3 to 5 times greater than the throughput design of our existing demonstration process reactors. This design threshold is intended to allow demonstration of static fluid bed reactor technology at one scale less than that required for full scale commercial deployment, but large enough to secure commercial fuel contracts with customers.

The specific projects are: 1) an expansion of the Colstrip, Montana demonstration site and 2) a plant integrated into Minnkota Power's M.R. Young power plant site near Center, North Dakota. These next generation projects would employ different aspects of the specific knowledge gained at the Colstrip demonstration project, providing efficient opportunities to advance the technology. These advances would allow further opportunities to gain the additional knowledge and experience necessary to ultimately commercialize this technology. At the same time these projects would result in construction investments totaling nearly $80 million, increasing the tax base, directly and indirectly they would provide approximately 400 new permanent jobs and increase economic activity by about $30 million per year.

The development activities of alternative fuel producers like Rosebud provide opportunities for the United States to take better economic advantage of our existing industrial and utility infrastructure while displacing imported foreign energy sources. These projects would produce value added products from low quality domestic feedstocks. They would continue the significant progress made in reducing environmentally threatening emissions while efficiently using our most abundant energy resource--coal.

When the United States Congress enacted Code Section 29 in 1980, it did so to encourage the domestic production of alternative fuel sources to decrease our dependence on the use of imported energy. In 1980 petroleum imports were 6365 Mbbl/day or 37.3 percent of our total petroleum use. By 1994, petroleum imports had grown to 8017 Mbbl/day or 45.5 percent of our total petroleum use. The projections for 1995 indicate that 53 percent of our petroleum needs will be met by imports. The original purpose for Section 29 is even more pressing today as the United States is demonstrating increased dependence on imported oil.

Nonconventional fuels like SynCoal® have shown a direct ability to displace petroleum products in both utility and industrial applications. SynCoal® has been used in place of natural gas and propane in direct fired kiln operations and has shown an ability to deslag utility boilers more effectively than fuel oil.

The U.S. Congress enacted Code section 29 in 1980 to encourage the domestic production of alternative fuel sources to decrease our dependence on the use of imported energy. Section 29 provides an incentive for the production and sale of fuels from designated non-conventional sources. The Senate Finance Report accompanying the enactment of Code section 29 stated that:

> The Committee believes that a tax credit for the production of energy from alternative sources will encourage the development of these resources by decreasing the cost of their production relative to the price of imported oil.
>
> **These alternative energy sources typically involve new technologies and some subsidy is needed to encourage these industries to develop to the stage where they can be competitive with conventional fuels.** Information gained from the initial efforts at producing these energy sources will be of benefit to the entire economy.[1]

Based on this legislative history, Rosebud believes that Congress originally intended to limit the credit to noncommercial scale production facilities. We submit that this original intent was proper and it forms the basis of our recommendation for a limited, targeted extension of Section 29.

Section 29 is a performance based incentive that only can be realized upon the sale of the nonconventional fuel product produced from the qualified facility. The taxpayer bears all technology and production risks and only receives the incentive after establishing its technical and operating capability and actually consummates a sale of the alternate fuels product. This structure minimizes the public's risk of providing incentives that do not provide the desired beneficial effects especially when limited to the production levels that support logical technology development.

An extension of Section 29 would provide important benefits for the United States. As mentioned previously, the evolution of a viable nonconventional fuels industry would contribute to the energy security of our nation. Additional benefits include further environmental and energy technology development that would assist in achieving compliance with Clean Air Act requirements, while providing additional employment for US workers. The successful development of a domestic nonconventional fuel industry would also lead to technology transfer in the international marketplace. Such endeavors would improve our trade deficits with other nations.

Rosebud believes there are important and compelling reasons to extend Code Section 29 and would urge this Committee and Congress to look favorably on a limited, targeted extension.

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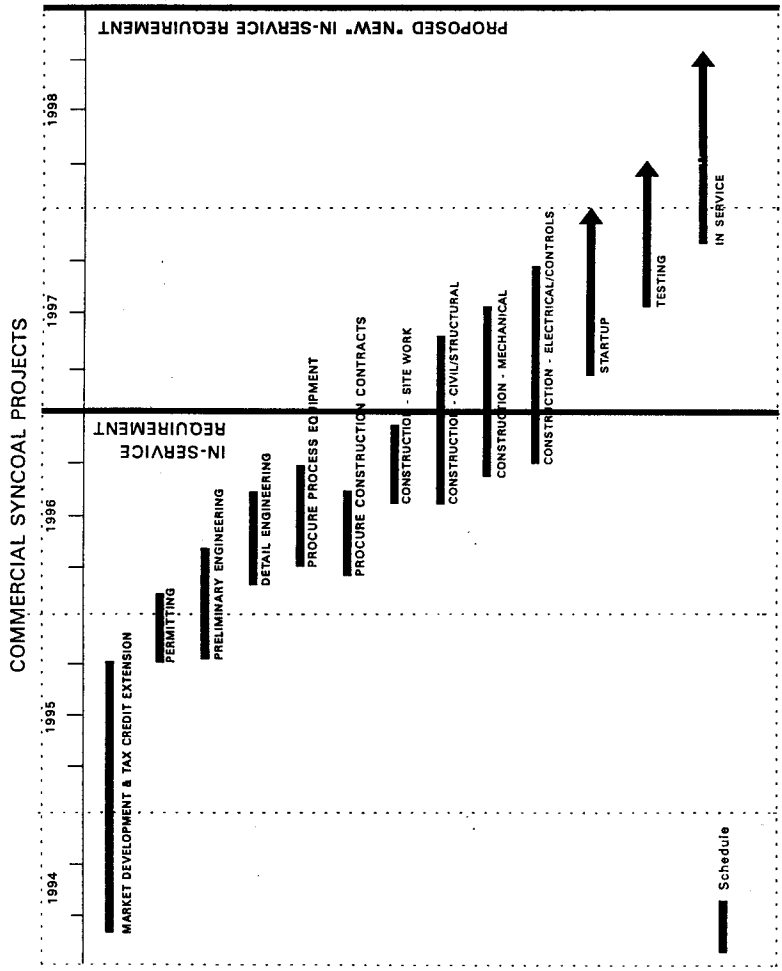
[1] S. Rept. No. 96-394, 96th Cong., 1st Sess. 87 (1979), 1980-3 C.B. 131, 205 (emphasis added).


COMMERCIAL SYNCOAL PROJECTS
1994
1995
1996
1997
1998
IN-SERVICE REQUIREMENT
PROPOSED "NEW" IN-SERVICE REQUIREMENT
MARKET DEVELOPMENT & TAX CREDIT EXTENSION
PERMITTING
PRELIMINARY ENGINEERING
DETAIL ENGINEERING
PROCURE PROCESS EQUIPMENT
PROCURE CONSTRUCTION CONTRACTS
CONSTRUCTION - SITE WORK
CONSTRUCTION - CIVIL/STRUCTURAL
CONSTRUCTION - MECHANICAL
CONSTRUCTION - ELECTRICAL/CONTROLS
STARTUP
TESTING
IN SERVICE
Schedule
Summary Timescale Schedule
TIMSCH-4/14/95

STATEMENT OF SAFETY-KLEEN CORP., ELGIN, ILLINOIS

Re-refining of Used Engine Oil

Safety-Kleen's Role in Managing Wastes

Safety-Kleen is the world's leading recycler of automotive and industrial hazardous and non-hazardous waste fluids. The Company processes and reclaims more than 200 million gallons of contaminated fluid each year collected from approximately 400,000 customers. The Company believes that only through proper handling can the hazardous waste portion of the world's wastes be safely managed to ensure the preservation of human health and the environment.

Safety-Kleen is exceptionally proud that the vast majority of its customer base is made up of small businesses, where jobs are being created and where the economy is having it's greatest current successes. Safety-Kleen's unique U. S. distribution system includes a network of 160 branches to collect wastes, 9 solvent Recycle Centers, one used oil processing facility and one used oil re-refinery to recycle, reclaim, or re-refine these wastes. Through these facilities, the Company provides services to customer locations throughout the United States.

The Company collects used lubricating oil from 64,000 customer locations in the U. S. These customers consist of car dealers, oil change outlets, gas stations automotive garages and many other small businesses. In addition, Safety-Kleen provides service to many of the nation's largest companies.

In short, Safety-Kleen teams effectively with small business, removing what used to be environmental and human health concerns and allowing those small businesses to do what they do best -- serve their customers and the economy.

Safety-Kleen's two used oil re-refineries in East Chicago, Indiana and Ontario, Canada processed approximately 112 million gallons of used oil during 1994. Since the majority of Safety-Kleen's customers are small businesses, the Company plays an additional key role beyond simply picking up used oil and other wastes. Safety-Kleen provides, as a matter of course, comprehensive and up-to-date information on the often complex environmental regulations and procedures with which its customers need to comply.

The Used Oil Issue

According to U.S. EPA figures, approximately 1.4 billion gallons of used oil are generated annually. Only about half of this amount is collected for recycling. Of the used oil collected, approximately 85% is burned as fuel and 15% is re-refined into base lube stock for reuse.

The adverse affects to the environment of improper disposal of used oil are as startling as they are well documented. One gallon of stray oil can render one million gallons of water undrinkable. Additionally, used oil frequently contains elevated concentrations of toxic metals, such as lead, which are picked up from contact with engine parts during use.

In response to the potential environmental damage posed by the improper management of used oil, the U.S. EPA promulgated used oil management standards in March, 1993, aimed at ensuring that used oil is managed in a manner that is fully

protective of human health and the environment. The used oil management standards appear in title 40 of the Code of Federal Regulations (CFR) part 279.

Although these regulations focus on proper management, they also recognize the value of used oil as a resource that can and should be reused, either through re-refining into lube stock or through burning as a fuel in appropriate units. Thus, the used oil management standards assume that used oil will be recycled, and are written in a manner to encourage collection and reuse.

Benefits of Re-refining

Officials with the U.S. EPA as well as significant elements of the environmental community have stated that re-refining is the preferred option for the recycling of used oil. Re-refining is considered by many "a higher use" than burning as fuel for energy recovery. Oil can be re-refined and re-used an unlimited number of times with no loss of quality, essentially renewing a resource once thought to be non-renewable. A state-of-the-art re-refinery, such as Safety-Kleen's East Chicago re-refinery, is capable of handling almost any used oil stream and converting it into quality lube stocks equivalent in all respects to virgin material.

Only two gallons of used oil are required to produce one gallon of lubricating oil, whereas, approximately 13 gallons of crude oil are required to produce one gallon of virgin lubricating oil. Re-refining also uses about one-third of the energy required to produce the equivalent amount of virgin lubricating oil. Thus, re-refining of used oil plays a role in reducing dependence on foreign energy sources and fossil fuels, both in regard to feedstocks used to produce lubricants and to energy requirements for the re-refining process.

The Re-Refining Process

Safety-Kleen's re-refineries use advanced technology (thin film evaporation and hydrotreatment which is the most evolved form of re-refining). This process provides the highest quality lube stock and produces the least amount of waste. In addition to the primary product, lube stock, the re-refining process also produces other useful products, such as asphalt extender, which is used in the manufacture of shingles or asphalt for roadways.

Safety-Kleen's re-refineries have pioneered many of the more innovative techniques used in re-refining. The promise of this new technology has led Safety-Kleen to invest in excess of $75 million of property, plant and equipment at the East Chicago, Indiana plant.

The Used Oil Industry

Safety-Kleen and Evergreen Oil Inc, of Newark, California produce the vast majority of re-refined oil in the United States. Re-refined oil makes up only about 15% of the total oil recycled in the country. At this time, the majority of used oil collected in the United States is processed for use as fuel by approximately 200 processing facilities. Both Safety-Kleen and Evergreen operate state-of-the-art re-refineries capable of producing quality lube stock that meets applicable industry standards for lubricants. Despite existing re-refiners success in producing quality products, the capital investment required to build or upgrade existing facilities into state-of-the-art re-refineries, coupled with slim profit margins, have generally discouraged entry into re-refining by other businesses.

In addition to raising the quality and the reputation of re-refined oil, Safety-Kleen's used oil collection and management procedures, which were modeled after the procedures it uses to manage hazardous waste, are the most stringent in the U.S. and have set a standard for environmental protection for the rest of the industry.

Quality of Re-refined Oil

Re-refining technology has made major advances over the past 15 years. The successful adaptation of refining technologies such as hydrotreating, a process which removes or destroys contaminants such as chlorinated compounds, allows the production of re-refined lube stock that meets or exceeds the standards set for lube stock refined from virgin oil.

Safety-Kleen has received International Standards Organization (ISO) 9002 accreditations for both its East Chicago and Breslau, Ontario, re-refineries. The Company's high-quality lube stock is blended, either by Safety-Kleen or by independent compounders-blenders or major oil companies, into a wide range of products. Safety-Kleen's own brand of engine oil made with re-refined lube stock is America's Choice, which is sold at Wal-Mart stores and other retailers.

Improvements in the quality of re-refined oil have led to increased market acceptance and interest. Several of the major oil companies are marketing their own brands of engine oil blended from re-refined lube stock produced by Safety-Kleen or Evergreen. Additionally, re-refined oil meeting the International Lubricant Standardization and Approval Committee's (ILSAC) GF-1 specifications received another important acknowledgement of its quality. The American Automobile Manufacturer's Association has stated that any oil, including re-refined motor oil, displaying the American Petroleum Institute's certification mark "starburst symbol" is suitable for use by its members (Chrysler Corporation, Ford Motor Company, and General Motors).

Both the U.S. government and a number of state governments are seeking to increase the market for re-refined oil by encouraging their own agencies to buy it through procurement preference guidelines. The U.S. EPA's Office of Solid Waste, Municipal and Industrial Waste Recycling Section, designated re-refined oil as an item that agencies should purchase in 1988 after careful review of its quality. Re-refined oil was also designated for preferential procurement by operating units (the Park Service, GSA, etc), of the Federal Government in an Executive Order 12873 on ***Federal Acquisition, Recycling, and Waste Prevention*** issued by President Clinton on October 20, 1993.

Additionally, in 1994, Safety-Kleen received the prestigious "Green Seal" certification for its re-refined engine lubricants. Green seal, an independent, non-profit organization, awards its certification to products found to cause significantly less harm to the environment than other, similar products.

Economics

Entry into the re-refining business has been expensive for Safety-Kleen. Factors that hinder entry into the business include high capital costs required to produce quality lube stocks, and the extensive and complex requirements covering regulatory compliance, operating permits and waste water discharges. The Company showed no return on its investment in the oil re-refining business from initial entry in 1987 until 1994, when a small profit was made.

Since the price of lube stock is tied to the cost of virgin crude, which has been relatively low over the past few years, profit margins are slim. The capital investment in the re-refineries and the cost of operating the Company's collection system represent fixed costs that cannot be adjusted downward.

Conclusion

Beyond the obvious benefits to small businesses nationwide and to the environment, government and industry endorsement of high-quality re-refined lube stocks, such as those produced by Safety-Kleen, underscores the importance of recycling used oil through re-refining. Because of the cost structure of the industry, however, re-refiners face stiff obstacles in order to produce re-refined products.

The process and promise of re-refining includes benefits to the environment as well as decreased reliance on imports. The hundreds of millions of gallons of used oil that have thus far been re-refined represent conservation of an important resource and protection of U.S. waterways and groundwater from improper disposal.

Re-refiners, who necessarily operate on a smaller scale than the major oil companies, are directly affected by the price of crude oil without the economies of scale of the major oil companies. Additionally, re-refiners must compete for used oil in the marketplace with used oil processors, or those organizations which convert used oil into fuels of various types. These oil processors naturally have lower levels of capital investment at a lower cost structure.

Thus, the extra costs associated with collecting and re-refining used oil are conceptually comparable to the costs associated with extracting crude oil from difficult-to-access deposits, or "non-conventional sources" and should be afforded comparable tax incentives.

In summary, we believe that a tax incentive as discussed here would have significant multiple benefits for the country; including helping our country's increasingly important small business community, helping to keep the environment clean for us and for future generations, and assisting an industry that can play an important role in helping America achieve true energy independence.

STATEMENT OF
SECTION 29 COALITION
ON SECTION 29 NONCONVENTIONAL FUELS TAX CREDIT

SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

May 9, 1995

The Section 29 Coalition supports the extension and improvement of the section 29 nonconventional fuels tax credit. The members of the coalition are companies involved in the production of gas from biomass and synthetic gas from coal or lignite.

Background of the Credit

The nonconventional fuels tax credit was enacted in 1980 as a means of encouraging the production of alternative forms of energy. The credit was set at $3.00 (plus an inflation adjustment) per barrel-of-oil-equivalent, and was designed to phase out during periods of high oil prices.

The principal effect of the credit during the 1980s was to stimulate the drilling of gas wells in eligible geological formations -- specifically, in tight sands, Devonian shale, and coal seams. However, Congress allowed the authorization for new wells in those formations to expire at the end of 1992. Gas produced from old wells in those formations will continue to qualify for the credit through 2002.

Refocused Credit

In the National Energy Policy Act of 1992, Congress extended the authorization for new energy "facilities" specified in section 29 -- specifically, for facilities used to produce gas from biomass or synthetic fuel from coal or lignite. To qualify under the 1992 extension, such a facility must be placed in service by the end of 1996, pursuant to a binding contract in effect by the end of 1995. Fuel produced in such a facility will qualify for the credit through 2007.

The net result of Congress's actions in letting part of section 29 expire and in extending the authorization for new facilities was to sharply refocus the credit. As refocused, the credit has essentially three effects: It promotes the production of clean fuels from coal and lignite; it promotes the recovery and productive use of methane produced in landfills; and it promotes the production of gas from other biomass -- such as wood waste.

The credit has helped stimulate the commercial development of coal gasification technology, under which high-sulphur coal or lignite can be efficiently transformed into a clean-burning gas. The first commercial-scale coal gasification facilities to be used in this country by electric utilities in power generation are scheduled to go into service in the next year. The success of the projects could lead to widespread use of coal gasification in the next century as a replacement for aging conventional coal-fired power plants. Compared to a conventional power plant, a power plant fueled with synthetic gas from coal or lignite will reduce emissions associated with acid rain to levels far below Clean Air Act standards, while also sharply reducing carbon dioxide emissions.

Similarly, the credit has stimulated more than 100 projects around the country to recover and use the methane gas generated in the decomposition of organic material in landfills. In the typical case, the gas is used on the landfill site to generate electricity. In other cases, the gas is piped off-site to an industrial plant or other gas consumer. Most of the projects are small, but, in their absence, the gas would simply be wasted. In cases where the landfill operator does not sell the landfill gas, the operator will collect sufficient quantities of the gas to prevent gas migration, and will flare the collected gas. The credit has encouraged companies to develop the technology to efficiently recover and use the landfill gas, thereby preventing the waste of a valuable resource.

Recommendations

The job of the section 29 credit is not finished. In the next century, gasification has the potential to be the preferred technology for the clean use of coal and similar fuels in generating electricity. Gasification is both cleaner and more efficient than conventional technologies. But because of the enormous cost of commercial-scale gasification facilities, the commercial feasibility of the technology needs to be demonstrated thoroughly before many utilities will be able to take the risk of adopting the technology. An extension of the authorization period for the section 29 credit would encourage more utilities to adopt the technology in the near future. The commercial feasibility of the technology could be fully demonstrated by early in the next century.

The credit also is needed as a continuing stimulus to encourage landfill owners to recover and use the methane gas produced in landfills. Many landfills around the country remain as possible candidates for landfill gas recovery and use, and new landfills will continue to come on line. The EPA has long promoted, and continues to promote, the environmental benefits of landfill gas recovery and use. Currently, the EPA is engaged in these efforts through its Landfill Methane Outreach Program. The section 29 credit not only is consistent with that program, but is essential to its success.

To ensure the continued benefits of the section 29 credit, Congress should extend the authorization period for new section 29 facilities for another four years. As a practical matter, if the authorization period is not extended for at least four years, the credit will provide no incentive for companies to construct coal gasification facilities or other such major projects because of the multi-year lead-times for those projects. In conformity with the four-year extension of the authorization period, Congress also should extend the 2007 date for the availability of the credit for four more years, through 2011.

Congress also needs to improve the credit in two respects:

First, Congress should amend the unrelated person sale rule to eliminate unnecessary red tape. Section 29 requires producers of eligible fuel to sell the fuel to unrelated persons to qualify for the credit. That rule creates an unnecessary burden in cases where an eligible fuel is best used on the site of production for the generation of electricity. For example, if a utility produces synthetic gas from coal and desires to use it on site to generate power, the utility must enter into an arrangement under which a third party will own either the gasification unit or the power generation unit; an unrelated person sale of the gas will result. Clearly, the tax law should not force taxpayers to take artificial steps such as this in order to take advantage of the credit. The Treasury has previously testified that the administration does not oppose eliminating the unrelated person sale rule. We suggest eliminating the rule in cases where the taxpayer uses fuel on the site of production to generate electricity and sells the electricity to unrelated persons; in those cases, the sale of the electricity can serve as an arms-length indicator of the volume of energy used and produced.

Second, Congress should clarify that the credit applies to synthetic fuels produced from petroleum coke, as well as from coal and lignite. Like coal and lignite, petroleum coke is a solid, impure, organic substance that can be used for fuel. Its heating value is higher than that of most coals, while its ash and moisture content are lower. A byproduct of petroleum refining, petroleum coke is produced in ever larger quantities because of the declining quality of the world's oil supply, while, at the same time, its continued utilization as a fuel is of increasing environmental concern due to its high sulfur content. The inclusion of petroleum coke in section 29 would provide an incentive for companies to demonstrate the gasification of the material on a commercial scale, thereby converting petroleum coke to a clean-burning fuel for use in the next century.

Summary

The section 29 credit represents an efficient mechanism for encouraging the development of alternative energy technologies, including technologies that let companies sharply reduce emissions associated with acid rain to meet the tightening Clean Air Act standards. Congress should extend the credit for another four years and also adopt appropriate amendments to improve the credit.

SMITHFIELD FOODS, INC.

IN SUPPORT OF THE

TARGETED JOBS TAX CREDIT (TJTC) PROGRAM

Smithfield Foods, Inc. is a $1.8 billion pork processor primarily located in the Mid-Atlantic United States with peripheral operations in Wisconsin and Utah. The Company operates numerous meatpacking plants throughout these regions employing large numbers of unskilled and semi-skilled workers for the work requirements of the meatpacking industry. The job positions, while not requiring extensive educational background, do require significant on-the-job training after hire date in order for the individual worker to be proficient and efficient in the production process. Meatpacking jobs lend themselves to the lesser skilled individual and provide prime possibilities for TJTC eligible people.

Under this program, Smithfield has put more than 600 people to work over the past few years who might otherwise have remained unemployed and on the welfare roles. This program has come under sharp criticism recently from the Labor Department for its supposed inefficient and wasteful nature. This claim, while always a possibility with any incentive program of government, is not the case with Smithfield Foods, Inc. Since 1981, Smithfield Foods, Inc. has actively recruited the hard-to-hire person utilizing the TJTC program as a key screening process. This program has been used to hire those who otherwise would not have been hired by our Company. This program has resulted in Smithfield actively pursuing employment of work release prisoners and disadvantaged youths as well as social services dependent welfare recipients.

In contrast to allegations made by the DOL that these people would be hired anyway, Smithfield has actively offered an alternative for convicted felons, to give them a job while imprisoned that continues after their release. Our success rate in retaining these employees after their imprisonment period has been good. We have in no way attempted to churn TJTC employees with other TJTC people once the credit has run, but rather have made every attempt to retain employees; the very nature of our business dictates retaining a trained workforce to the extent we possibly can. In addition, DOL has alleged that TJTC people are hired on a part-time basis with little or no benefits, I again challenge this premise. The vast majority of TJTC persons at Smithfield Foods are full-time, 40-hours plus employees and all employees receive a full compliment of benefits including vacation, health and life insurance and attendance bonuses. I have attached to this letter some statistics supporting our utilization of the program which I ask be reviewed and considered as well as specific case analysis of people hired who have remained long after the credit has expired.

I feel it unfortunate that a program that can work and does work to improve society is likely to be eliminated. I am not embarrassed to admit that Smithfield Foods, Inc. has benefitted from these tax credits over the past years; this is the reason the program was enacted. I do, however, feel very strongly that in the case of our Company, the program has worked exactly as it was supposed to. A tax credit program was passed as an incentive for industry to hire those members of society with limited skills and problem backgrounds. In return for this, industry is rewarded with a modest financial incentive in the form of tax credits for hours worked. This is a successful program, both for industry and for society.

This is not a wasteful program, and properly structured, this can be an important avenue for those seeking real gainful employment. I urge your support for renewal of the program and thank you for your time and consideration.

C. Larry Pope
Controller

The following information is being submitted in an effort to provide an optimistic view regarding the future of the Targeted Jobs Tax Credit (TJTC) Program. This information not only voices our support for the program, but outlines procedures which we have implemented that have proven to be effective in accomplishing objectives in both the public and private sectors.

Smithfield Foods, Inc. has been a long time participant in and supporter of programs that were created to provide assistance for disadvantaged individuals. We recognize the importance of a cooperative relationship between the public and private sectors and actively strive to maintain this relationship. The proactive measures we have taken to become involved with public service agencies and their purposes clearly demonstrate our concern and dedication to becoming an integral part of the solution to many problems we face when attempting to provide assistance for the less fortunate. Our most important resource is our human resource. The very nature of our business requires that we employ, train and retain a productive workforce. Through the TJTC program we are able to provide employment opportunities for disadvantaged individuals who may only need just that, "the opportunity".

As stated in the Department of Labor's TJTC ET Handbook 377, "TJTC is intended to further the partnership between the employment and training system and the private sector in dealing with problems of the disadvantaged and unemployed. TJTC is a significant part of this effort and a cost-effective way of increasing private sector employment opportunities. It offers taxpaying businesses incentives to increase the number of job opportunities available to the disadvantaged and to retain these workers in the critical first year of employment". The purpose and objectives behind this program could not be more appropriate. Especially when our country faces problems concerning unemployment and Welfare Reform. We do not feel that problems that may appear to exist with TJTC are within the structure of the program itself, but in the manner in which the program is implemented. Proper implementation requires teamwork and effort on the part of both the private and public sectors. We have recognized this deficiency. We have created and implemented a new approach that has proven to be mutually beneficial in both sectors.

In 1993, the position of Human Resources, Government Incentive Program Coordinator (GIPC) was implemented in one of our facilities. The results have been extremely successful and we are considering implementation on a corporate level. The primary responsibility of this position is to act as a liaison between the company and the public sector in the Human Resources arena. A Coordinator was hired into this position and brought with him seven (7) years of pubic sector experience in programs designed to assist

disadvantaged individuals in finding employment. Knowledge and experience in both the private and public sectors have proven to be the key ingredients in eliminating existing obstacles that may inhibit proper program implementation and prevent any private sector employer from utilizing programs in the manner in which they were intended.

The following information outlines the responsibilities of the GIPC. These are essential components attributed to our success.

* **EDUCATION**

  Educating the Human Resources Department on the purpose of TJTC and other Government Programs.

* **PUBLIC RELATIONS**

  Creating and actively maintaining positive working relationships with all public service agencies charged with the responsibility of assisting disadvantaged individuals in becoming gainfully employed (i.e. Department of Social Services, Department of Corrections, Department of Rehabilitative Services, JTPA Agencies, etc.)

* **RECRUITMENT**

  Presentations at the above-mentioned agencies for clients who are job-ready and are actively seeking employment. These presentations educate clients on our industry and the types of employment available.

* **ASSESSMENT**

  Potential employees are referred for individual assessment. Topics are discussed such as requirements necessary to become and remain employed, reliable transportation, and what positions might be most suitable for the client based on their needs. If deficiencies exist that absolutely prevent an individual from being considered for employment (i.e. no transportation), suggestions are offered on how the obstacle may be overcome.

* **ELIGIBILITY DETERMINATION**

  Potential employees are screened for TJTC eligibility and informed of other programs that can be of assistance when seeking employment with any employer. Individuals who have demonstrated a strong desire for opportunity will be considered for employment as vacancies arise.

* **RETENTION**

  Once individuals are employed, they are informed that the GIPC is always available for assistance should problems arise during their employment. They are encouraged to discuss potential problems with the GIPC in an effort to resolve them before they become problems that may affect their employment.

The following statistics and employment profiles justify the information presented above and strongly contradict the negative results and criticism produced by the investigation conducted by the Office of the Inspector General (OIG).

SMITHFIELD FOODS, INC.
ANALYSIS OF TJTC PROGRAM
HISTORY OF EMPLOYEES HIRED

TARGET GROUP	1994	1993	1992	1991	1990
A - Vocational Rehabilitation Referral	3	2	2	-	1
B - Disadvantaged Youth (Age 18 - 22)	100	56	30	4	-
C - Disadvantaged Vietnam Era Veteran	8	3	-	-	5
D - Supplemental Security Income Recipient	3	3	-	1	-
E - General Assistance Recipient	2	1	3	-	-
F - Disadvantaged Youth Participating in a Cooperative Education Program	-	-	-	-	-
G - Disadvantaged Ex-Offender	66	37	63	15	-
H - Eligible Work Incentive Employee or AFDC Recipient	83	35	61	16	-
J - Qualified Summer Youth	1	-	-	-	-
	264	137	159	36	16

Total employees hired under the program over the past five years 612

THE FOLLOWING IS A SMALL SAMPLE OF EMPLOYMENT PROFILE SUMMARIES FOR INDIVIDUALS WHO WERE HIRED INTO COMPANIES WITHIN SMITHFIELD FOODS, INC. UNDER THE TARGETED JOBS TAX CREDIT (TJTC) PROGRAM. PERSONAL/CONFIDENTIAL INFORMATION IS BEING WITHHELD IN ACCORDANCE WITH THE PRIVACY ACT.

EMPLOYEE #1

HISTORY:	* Female - 18 years of age * Single mother * Previous work history - none * Department of Social Services referral AFDC and Food Stamp Recipient * High School/GED - Yes
ASSESSMENT/ SCREENING:	10/25/93
TARGET GROUP:	B - DISADVANTAGED YOUTH (18-22 yrs. old) H - AFDC RECIPIENT
START DATE:	10/27/93
STARTING WAGE:	$ 6.00
CURRENT WAGE:	$ 7.58
BENEFITS:	Yes
COMMENTS:	Employee has been employed for 1 year and 6 months. She is currently employed in our Cut Department, self-sufficient and has not had to return to the welfare system.

EMPLOYEE #2

HISTORY:	* Male - 48 years of age * Married, father of one * Previous work history - Military USAF * High School/GED - Yes
ASSESSMENT/ SCREENING:	8/13/93
TARGET GROUP:	C - DISADVANTAGED VIETNAM ERA VETERAN
START DATE:	9/20/93
STARTING WAGE:	$ 5.96
CURRENT WAGE:	$ 7.56
BENEFITS:	Yes
COMMENTS:	Employee has been employed for 1 year and 7 months. He has been re-trained to be a skilled production worker in the meat production industry.

EMPLOYEE #3

HISTORY:	* Male - 33 years of age * Single * Previous work history - Construction (sporadic) * Department of Corrections referral * High School/GED - Yes
ASSESSMENT/ SCREENING:	9/13/93
TARGET GROUP:	G - DISADVANTAGED EX-OFFENDER
START DATE:	9/20/93
STARTING WAGE:	$ 5.96
CURRENT WAGE:	$ 7.58
BENEFITS:	Yes
COMMENTS:	Employee was incarcerated 11/89 - 8/93. Upon release, he was referred for employment. After demonstrating a strong desire to "make it work" he was provided an employment opportunity, trained and continues to be a productive employee in our AB Pack Department.

EMPLOYEE #4

HISTORY:
* Female - 31 years of age
* Single mother
* Previous work history - Retail (last employment 5/88)
* Department of Social Services referral
* High School/GED - Yes

ASSESSMENT/ SCREENING: 8/06/93
TARGET GROUP: H - AFDC RECIPIENT
START DATE: 9/20/93
STARTING WAGE: $ 5.96
CURRENT WAGE: $ 8.06
BENEFITS: Yes

COMMENTS: Employee has been employed for 1 year and 7 months. Previously, she had not been gainfully employed for over 5 years. She is currently employed in our AB Pack Department and has substituted as Crew Leader on occasion.

EMPLOYEE #5

HISTORY:
* Male - 24 years of age
* Disabled
* Previous work history - Varied, not working more than 4 months in one location.
* High School/GED - No

ASSESSMENT: 11/09/94
TARGET GROUP: D - SUPPLEMENTAL SECURITY INCOME RECIPIENT
START DATE: 11/12/94
STARTING WAGE: $ 6.17
CURRENT WAGE: $ 7.70
BENEFITS: Yes

COMMENTS: Employee has been employed for 5 months. He was hired in our Plant Clean-Up Department responsible for sanitation according to USDA regulations. He has recently been promoted to Crew Leader.

SOUTHWEST AIRLINES
PILOTS' ASSOCIATION

Phillip D. Mosely
Chief of Staff
Committee on Ways & Means
1102 Longworth HOB
Washington, D.C. 20515

Dear Mr. Mosely:

On behalf of the approximately 2,000 pilots of Southwest Airlines, I am writing to request that the October 1st imposition of commercial jet fuel taxes be not simply postponed but removed from current law entirely.

The airline industry has, as a whole, recently begun to show some signs of improvement. Unfortunately, this improvement is marginal at best. The industry hasn't made a profit in 5 years. Analysts expect, but will not guarantee, a profit for the industry in 1995. The projected return on investment for 1995 is minimal, less that 1%, whereas a good return for American industry as a whole is in excess of 5%.

The 'return' of profits is not universal. Numerous airlines are struggling, notably Continental, USAir and TWA, not to mention Reno Air, Kiwi, Midway and others. The imposition of fuel taxes will make their fight to survive almost insurmountable - and extinct carriers pay no taxes.

Employee groups have made many sacrifices in an effort to return their carriers to some semblance of profitability. United, Northwest and TWA are examples wherein labor groups gave up tens and hundreds of millions of dollars in wage concessions. USAir is struggling to survive and its unions are working on a package of wage cuts and concessions at this time. Continental and America West employees have had no contracts or raises in years. At SWA, our pilots recently accepted a contract with no scheduled raises for five years. Are our sacrifices for the sake of our employers to be sacrificed? If that isn't enough, 120,000 airline employees have been cut or furloughed since 1990 - and the cutting is not yet finished.

In 1990 Congress increased taxes and authorized airports to begin charging Passenger Facility Charges. These two items alone added a further burden of $2 billion dollars annually to an industry losing hundreds of millions of dollars each year. The fees and taxes imposed by Congress are required to be paid regardless of profitability. Since 1990 the industry has lost an incredible $12.8 billion! Passenger and cargo taxes total over $6 billion annually. Is there something wrong with this picture?

This fuel tax, if imposed, is estimated to cost the industry some $527 million annually. The cost to Southwest Airlines will be approximately $30 million - double our profit in the first quarter. Can SWA and the other carriers pass this cost on to the consumer through higher fares? The answer, simply put, is NO. The industry is going through what most analysts consider one of the final phases of deregulation, one in which competition is severe. Fares simply cannot be raised in this market. The end results will be lower profits for some and larger losses for most, with predictable economic consequences.

The airline industry is beset with serious financial, labor, and competitive difficulties. The National Airline Commission recommended NO to the 4.3 cents-per-gallon fuel tax. And so, too, do the pilots of Southwest Airlines.

We strongly recommend this untimely tax be laid to rest. Please repeal the onset of the October fuel tax on the basis of good economic policy, not just for Southwest Airlines, but for the entire industry, their employees and the nation as a whole.

Sincerely yours,

Gary L. Kerans
President

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