SELECT TAX ISSUES

HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

SEPTEMBER 23, 2004

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SELECT TAX ISSUES

THURSDAY, SEPTEMBER 23, 2004

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, DC.

The Subcommittee met, pursuant to notice, at 11:33 a.m., in room 1100, Longworth House Office Building, Hon. Jim McCrery (Chairman of the Subcommittee) presiding.

[The advisory, revised advisory, and revised advisory #2 announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SELECT REVENUE MEASURES

FOR IMMEDIATE RELEASE CONTACT: (202) 226–5911
September 15, 2004
No. SRM–4

McCrery Announces Hearing on Select Tax Issues

Congressman Jim McCrery (R–LA), Chairman, Subcommittee on Select Revenue Measures of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on select tax issues. **The hearing will take place on Thursday, September 23, 2004, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Subcommittee and for inclusion in the printed record of the hearing.

BACKGROUND:

This hearing provides non-Committee on Ways and Means Members of the House the opportunity to testify on tax issues of importance to their constituents.

In announcing the hearing, Chairman McCrery stated, "It is important to hear perspectives on tax issues from Members who do not sit on the Committee on Ways and Means. This hearing offers an opportunity for those Members to share their proposals and ideas for simplifying and improving the U.S. Tax Code, as well as discuss tax policies of particular interest to their constituents."

FOCUS OF THE HEARING:

The hearing will allow Members of the House who do not sit on the Committee on Ways and Means to testify on discrete tax legislation.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, *http://waysandmeans.house.gov*, select "*108th Congress*" from the menu entitled, "*Hearing Archives*" (*http://waysandmeans.house.gov/Hearings.asp?congress=16*). Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, completing all informational forms and clicking "submit" on the final page, an email will be sent to the address which you supply confirming your interest in providing a submission for the record. You ***MUST REPLY*** to the email and ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business Thursday, October 7, 2004. **Finally**, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item 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 submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

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. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at *http://waysandmeans.house.gov*.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SELECT REVENUE MEASURES

FOR IMMEDIATE RELEASE
September 23, 2004
SRM–4–Rev

CONTACT: (202) 226–5911

Change in Time for Hearing on Select Tax Issues

Congressman Jim McCrery (R–LA), Chairman, Subcommittee on Select Revenue Measures of the Committee on Ways and Means, today announced that the hearing on select tax issues, previously scheduled for Thursday, September 23, 2004, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m., **will now be held at 2:00 p.m.**

All other details for the hearing remain the same. (See Subcommittee Advisory No. SRM–4 dated September 15, 2004.)

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON SELECT REVENUE MEASURES

FOR IMMEDIATE RELEASE
September 23, 2004
SRM–4–Rev 2

CONTACT: (202) 226–5911

Change in Time for Hearing on Select Tax Issues

Congressman Jim McCrery (R–LA), Chairman, Subcommittee on Select Revenue Measures of the Committee on Ways and Means, today announced that the hearing on select tax issues, previously scheduled for Thursday, September 23, 2004, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m., **will now be held at 11:30 a.m.**

All other details for the hearing remain the same. (See Subcommittee Advisory No. SRM–4 dated September 15, 2004.)

Chairman MCCRERY. The hearing will come to order. I would ask everyone to take a seat, please. Good morning, everyone. Today, the Subcommittee on Select Revenue Measures will hear testimony from both Republican and Democrat Members who do not sit on the Committee on Ways and Means. Their testimony will assist our Committee in exploring ways to improve the tax system. After all, it has been my experience that every Member of the Congress, regardless of what Committee he or she is on, has an opinion about the Tax Code. So, it is only appropriate that the Committee on Ways and Means should hear from those Members directly. It has been said that we are not the bosses of taxpayers, they are ours, and as we recognize that Members of Congress are here to serve taxpayers, it is important that Members of Congress are responsive to taxpayers whose lives are affected in various ways by our tax laws. This hearing offers the opportunity to hear from Members regarding tax proposals that are important to their constituents. Our Tax Code, I think we all can agree, is far from perfect. Many have called it hopelessly complex. As policymakers, we must continue to make improvements to the system. I believe this hearing will assist the Committee in our efforts to improve the tax system, and I look forward today to hearing from all of our honored guests as they discuss their proposals and give us the benefit of their expertise and their experience from their own districts. Now I would recognize my good friend and the Ranking Member on the Subcommittee, Mr. McNulty.

Mr. MCNULTY. Thank you, Mr. Chairman. I welcome my colleagues and other interested parties here today. Mr. Chairman, I am not going to read my statement; I would just like to submit it for the record and summarize. It is my observation that many Members of the U.S. House of Representatives who are not Members of the Committee on Ways and Means not only have opinions about the tax law, many are more expert in certain sections of the tax law than Members who sit on this Committee. Many Members have been proposing various changes to the Tax Code for literally years, and I believe that a number of those proposals deserve not only a hearing by this Committee but adoption by the House of Representatives. So, I am very pleased to welcome our colleagues here today, many of whom have spent a great deal of time on these proposals over a very long period, and I am especially grateful to you, Mr. Chairman, for affording them this opportunity.

[The opening statement of Mr. McNulty follows:]

Opening Statement of The Honorable Michael R. McNulty, a Representative in Congress from the State of New York

Thank you, Mr. Chairman. I applaud Chairman McCrery for scheduling this important hearing and his outreach to me to insure Member participation on a bipartisan basis. I welcome all of the Members testifying before the Subcommittee today, and very much appreciate your willingness to personally share your views on tax legislation of important interest to your constituents.

Today's hearing has been scheduled to provide House Members—those not serving on the Ways and Means Committee—with the opportunity to present testimony in support of tax bills, introduced during the 108th Congress, which have been referred to us for consideration. Also, we can use today's hearing to discuss legislative proposals, particularly in the area of tax simplification, which Members are in the process of developing.

The Select Revenue Measures Subcommittee has a long tradition of holding hearings on what are often called "miscellaneous tax" bills. The Subcommittee was reconstituted within the Ways and Means Committee, beginning with the 107th Congress, with the primary responsibility of considering tax bills of unique interest to specific Members of Congress and their constituents.

Too often, Members' bills can get "lost in the shuffle" while the more wide-reaching, major tax initiatives of the day dominate the Committee's attention and focus. I am pleased that we are able to offer Members this opportunity before the end of the 108th Congress.

Chairman MCCRERY. Thank you, Mr. McNulty. This morning we will begin with Ms. Capps, as she has a markup I believe to get to in just a few minutes. So, we are going to allow her to go first. Ms. Capps.

STATEMENT OF THE HONORABLE LOIS CAPPS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. CAPPS. Thank you, Mr. Chairman, and Members of the Subcommittee. I thank you for holding this hearing today of the Subcommittee on Select Revenue Measures, and for this opportunity to present testimony in support of H.R. 2360, the Capital Construction Fund (CCF) Qualified Withdrawal Act. This legislation would allow fishermen to use their CCF savings for nonfishing purposes. The recent U.S. Commission on Oceans Policy report made clear that our oceans are in crisis and action needs to be taken at the Federal level to restore the health of our ocean ecosystems. The commission's report contained a variety of important legislative recommendations, including reforming the CCF to reduce overcapitalization of America's fishing fleets, and last year I introduced legislation, this bill, to do just that. My bill will give fishing families greater access to their own money in this CCF. The CCF works like an individual retirement account (IRA): deposits to the fund earn tax-deferred interest and are deducted from the fishermen's taxable income. It is a way for fishermen to accumulate funds free from taxes for the purpose of buying and refitting fishing vessels. However, if fishermen withdraw funds for purposes other than buying new vessels or upgrading their current vessels, they can lose up to 70 percent in taxes and penalties.

The program successfully expanded the U.S. fishing industry by allowing fishermen to rapidly accumulate the funds necessary for future expansion. That was in the past. Unfortunately, as the commission's report noted, the CCF is unintentionally at this point contributing to the problems facing U.S. fisheries by encouraging the growth of U.S. commercial fishing fleets. Because of the environmental problems plaguing commercial fishing as well as the need in many cases for fishing fleet downsizing, the CCF has outgrown its original purpose. The CCF Qualified Withdrawal Act encourages more sustainable fishing practices by allowing CCF funds to be used for purposes other than the purchase or reconstruction of fishing vessels. This bill will allow fishermen to roll over funds currently in the CCF into IRAs or other types of retirement accounts without adverse tax consequences to the account holder. The funds rolled into an IRA would be taxed upon withdrawal from that retirement account as are regular IRA contributions. In addition, the funds could be paid to individuals who are leaving a fishery as part of a capacity reduction program, or for the acquisition of vessel monitoring systems or fishing gear designed to avoid untargeted marine life caught while fishing for other species.

Both the fishing and the environmental community support this legislation. It has been endorsed by the Fisherman's Marketing Association, the Oregon Trawl Commission, Pacific Marine Conservation Council, Oceana, Natural Resources Defense Council, Cape Cod Commercial Hook Fisherman's Association, and Trawlers Survival Fund. You can tell it is bipartisan and bicoastal, the support for this legislation. Mr. Chairman, at a time when the fishing industry is in trouble it makes sense to open the CCF for other purposes. By allowing fishermen to access their money without severe tax penalties, we can give more options to those who wish to pursue other careers or retirement which in return will help the industry as a whole. With this bill we can pursue twin goals: sustain America's fisheries, and also protect the financial security of fishing families. Again, thank you, Mr. Chairman and Members of the Committee, for your interest in this CCF Qualified Withdrawal Act. I hope the Committee will approve this legislation which means so much to my constituents and fishing families across this country. Thank you.

[The prepared statement of Ms. Capps follows:]

Statement of The Honorable Lois Capps, a Representative in Congress from the State of California

Mr. Chairman and members of the Subcommittee, thank you for holding this hearing today and for the opportunity to present testimony in support of H.R. 2360, the Capital Construction Fund Qualified Withdrawal Act. This legislation would allow fishermen to use their Capital Construction Fund savings for non-fishing purposes.

The recent U.S. Commission on Oceans Policy report made clear our oceans are in crisis and action needs to be taken at the federal level to restore the health of our ocean ecosystems. The Commission's report contained a variety of important legislative recommendations, including reforming the Capital Construction Fund to reduce overcapitalization of America's fishing fleets.

Last year, I introduced legislation to do just that. My bill will give fishing families greater access to their own money in the Capital Construction Fund.

The CCF works like an IRA—deposits to the fund earn tax-deferred interest and are deducted from the fishermen's taxable income. It is a way for fishermen to accumulate funds, free from taxes, for the purpose of buying or refitting fishing vessels. However, if fishermen withdraw funds for purposes other than buying new vessels or upgrading current vessels, they can lose up to 70% in taxes and penalties.

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In addition, the funds could be paid to individuals who are leaving a fishery as part of a capacity reduction program, or for acquisition of vessel monitoring systems or fishing gear designed to avoid untargeted marine life caught while fishing for another species.

Both the fishing and the environmental communities support this legislation. It has been endorsed by the Fisherman's Marketing Association, Oregon Trawl Commission, Pacific Marine Conservation Council, Oceana, Natural Resources Defense Council, Cape Cod Commercial Hook Fisherman's Association, and Trawlers Survivors Fund.

Mr. Chairman, at a time when the fishing industry is in trouble, it makes sense to open the CCF for other purposes. By allowing fishermen to access their money without severe tax penalties we can give more options to those who wish to pursue other careers or retirement, which in turn will help the industry as a whole.

With this bill we can pursue twin goals—sustain America's fisheries and protect the financial security of fishing families.

Again, thank you Mr. Chairman and Members of the Subcommittee for your interest in the Capital Construction Fund Qualified Withdrawal Act. I hope the Committee will approve this legislation, which means a lot to my constituents and fishing families across the country.

Thank you.

Chairman MCCRERY. Thank you, Ms. Capps; very good concise testimony. Speaking of concise, I am sure you are all aware we are under the 5-minute rule for presentation of remarks, oral remarks. Your written testimony will be inserted in the record in its entirety. Next, we have a gentleman who has been pursuing changes in the Tax Code for some time along areas of his interest, and he is here today to tell us about one of those, Johnny Isakson from Georgia.

STATEMENT OF THE HONORABLE JOHNNY ISAKSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF GEORGIA

Mr. ISAKSON. Thank you, Mr. Chairman and Ranking Member. I appreciate the opportunity of being here today and discussing with you H.R. 2036, which I have introduced and have talked about to this Committee once before. I come back to you today understanding the timing of the session is close, but also understanding the importance of us really paying attention to our environment and to development of this country, and to creating positive ways that incentivize our communities, the development community and our conservation community, to protect our precious homeland and use it as an asset for generations to come. Mr. Chairman, in the last 225 years our country, the continental United States has lost 52 percent of its wetlands. In a 5-year period between 1992 and 1997, the urban footprint of the United States of America grew by 15 percent. We are a rapidly growing Nation, and with that we have lost a tremendous amount of open and greenspace. I have worked for some time and professionally all my life, I was in the real estate brokerage and development business, with real property, with the development of real estate, with the consequences of growth, and with the rising and urgent need to understand that our environment is our amenity package for our country and for its development.

House Resolution 2036 takes the approach to create a 5-year program, $25 billion in tax credits to be used for the purpose of the purchase of conservation easements, according to a statewide comprehensive plan allocated among the States by conscientious formula, to see to it that we do everything we can to protect our open and greenspace. The bill is named after the late Paul Coverdell, who was the U.S. Senator from Georgia until his death 4 years ago, who began this effort, and I have picked up its mantle and am doing everything I can to raise the visibility of this important purpose. Mr. Chairman, I guess the best way I can emphasize my strong belief in this is to tell you the following. My last effort as a private businessman before I came to the Congress of the United States was the development of a 300-acre tract of land on the Chattahoochee River in Atlanta, in suburban Atlanta. I was also a part of the Trust for Public Land's effort to create the Chattahoochee Greenway, which is substantially created in our State now to protect our State's largest natural resource and water supply, the Chattahoochee River.

The property that we purchased along that river had significant environmental challenges, and developers in the area and other pieces of property had taken the old approach of trying to figure out how to shoehorn into a piece of property all the development they could with less than the important interest and intensity on the environment. We took another approach, and we took a risk. The risk was that we would protect what ended up being about 22 percent of the total land area purchased into a conservation park. We named that park after the former President of the Georgia Conservancy; we sold to the Trust for Public Land the river frontage, and we took the undevelopable or questionably-developable land, created it into a seamless park throughout the development as the amenity package for this community. It was the biggest hit in the metropolitan Atlanta area and development for years, and it wasn't because of any genius of the developer or sales and marketing techniques; it was because Americans were willing to pay for what all of us love and appreciate, and that is our natural resource. I would like to ask unanimous consent, in addition to my testimony which I previously submitted, to submit a Yale University study on the value of conservation easements as well as a comprehensive summary of this bill. Mr. Chairman, I believe——

Chairman MCCRERY. Without objection.

[The information was not received at the time of printing.]

Mr. ISAKSON. I believe the tax policy drives economic policy and decisions, and I think paramount among our considerations as public policymakers in the years ahead must be the quality of our own and greenspace and our environment. I am a believer that a developing country can be a partner with the environment in which that country develops. Our most important assets for my grandchildren are our waters, our air, and our greenspace, as well as the opportunity to thrive in the business community in the free enterprise system. It is incumbent upon us to create mechanisms to make great partnerships between the development community and the environmental community. Good tax policy, H.R. 2036, and a focus toward environmental and conservation easements versus trying to consume through purchase all the land necessary to protect, gives America a 10 to 1 return on its investment and a comprehensive plan State-by-State to ensure that our future is bright, our air is clean, and our water is safe. I thank the Chairman.

[The prepared statement of Mr. Isakson follows:]

Statement of The Honorable Johnny Isakson, a Representative in Congress from the State of Georgia

Mr. Chairman, ladies and gentlemen of the Subcommittee. I want to say how grateful I am to you for allowing me the opportunity to discuss H.R. 2036.

Let me preface this by saying that one year ago I stood before you making the same plea. I am here again because I believe H.R. 2036 offers us an opportunity to make a difference in our environmental policy—one which is fiscally responsible yet effective and productive. I believe that all of us have a responsibility to preserve our environment and our quality of life. H.R. 2036 has long term benefits with immediate and visible results that answer some of the greatest environmental concerns this country has ever faced; effective immediately.

I am confident that tax policy is one of the largest drivers of economic policy as it determines where and how and how much the consumer and private sector invest and spend their earnings, especially in the housing and land development sector. By using tax credits given for land easements we respect property rights, we preserve the environment and we use God's natural gifts as they were meant to be used. Overall, the proposed $25 billion in tax credits over the next five years will in the long run save the taxpayer and government billions, improve air and water qualities, increase desperately needed greenspace, allow farmers to produce our vital food supply and improve the overall quality of America's communities. How do I know this is true? Because I have seen it work first hand.

I represent the Sixth Congressional District of the State of Georgia. My district falls directly in greater Metro Atlanta, the country's fastest growing urban area. It is not hard to see the impact urban development has had on our city's environment. Simply by looking at aerial photographs anyone will notice that unless we act soon, America's most precious land will be consumed by urban development. Our air and water quality is poor and getting worse throughout the country, natural ecosystems are being destroyed, and farmers are being forced to sell their land in lieu of neighborhood developers.

When I first saw the proposal of what is now the largest protected natural waterway and greenway of any urban city in America, I knew the idea was brilliant. It allowed a nonprofit group specialized in acquiring land to leverage $25 million in federal funds to eventually raise an additional $105 million in private funding and acquire 60 more miles of riverfront property to remain intact in its natural state. All this was done while keeping the land in the hands of the private owner.

Mr. Chairman, we have a large environmental crisis on our hands. From 1992 to 1997 alone, 15% of the nation's total urban development occurred. Since the beginning of our nation's history, the lower 48 states have lost 52% of their original wetlands. Of the 76 eco-regions in that same area, only nine are considered not to be critical, endangered or in a vulnerable condition as habitat for the species they contain. If current development and population trends continue, by the year 2050 our farmers and ranchers will be required to produce food for 50% more Americans on 13% less land. The list of problems goes on and on. We must act now.

H.R. 2036 will direct and empower all levels of government, land trust, taxpayers, and landowners to work in an aligned partnership, focused at the local level to conserve and restore our natural infrastructure for generations to come. Additionally, the economic gains give a substantive incentive for this plan. The conserved areas will filter our water and protect it with earth's natural and finest purification. They will clean our air. They will keep our fisheries and foodstocks healthy and productive. They will provide much needed greenspace for everyone while simultaneously freeing us the cost of artificially replacing these same services, and I think it will send a strong and positive message to the community that we value our land and our environment above building for the sake of building. As people realize the value of our environment's natural state and the limited nature of land, it will force wise development decisions and encourage city innovation.

Mr. Chairman, just last week we saw the effects of nature's natural course on human development. With severe flooding and mudslides in the wake of three back to back hurricanes, we again realize how vital our nation's wetlands are that act as a buffer for surrounding rivers and creeks. As a safety precaution among all the other benefits, this legislation will do the job.

When I was the president of Northside Reality, my last development project was a residential neighborhood in Atlanta named Wild Timber. What happened was an amazing phenomenon. We decided to sell the riverfront property to the Trust for Public Land to ensure that it would be preserved and then we promised to preserve 20% of the land area as greenspace to act as common buffers behind houses and along streams. Basically, we banked on using the environment as our amenity package rather than paving tennis courts, multiple swimming pools and parking lots, and the people loved it. We broke all development records in absorption and popularity as people flocked to enjoy what we had preserved just as much as what he had built. People want greenspace. People enjoy preservation and they understand that the cost of not taking care of our environment from both an economic perspective and a social perspective is, in the long run catastrophically high.

Mr. Chairman, using tax incentives as a catalyst to raise capital in order to preserve land makes sense. It is not merely a textbook theory, but it has been proven through trial. Because of tax incentives one decade ago, the low-income housing standards have risen dramatically with large capital investments. Because of tax incentives on mortgages, home ownership in our great country is at an all time high and remains the highest in the entire world. In Atlanta where we first tried the idea of the Chatahoochee River Greenway Project, it worked tremendously well and is now the largest preservation project in urban America.

I understand that anything we pass cannot just be a good idea if it does not win the support of the people. In our initial polling, we found overwhelming support concerning the principles of H.R. 2036 that extended beyond all party lines, geographic lines, and social lines.

H.R. 2036 is an innovative idea and will set the precedent now to preserve what land we have left before it is gone. It holds true to the principle of America's foundation, a right to private property. It encourages a spirit of conservation. It promotes collaboration and the formation of an integrated partnership between the public and private sector, all working together for common good. My colleague and good friend, the late Senator Paul Coverdell believed in this bill, and I am honored to take his and others' great ideas to be the torchbearer before you today.

Mr. Chairman, I understand the huge concerns surrounding the budget deficit and starting new projects. However, the need for land conservation has never been greater than today. This small window of opportunity will be lost as time progresses. Developed land can never again be recovered. Every one of us knows that land must be preserved and that the environment must be protected. By merely purchasing land through government appropriations, it is not possible to conserve as much that is needed. Without unlimited funds, it is impossible to make that method work. In order to get the most land for our dollar, H.R. 2036 proposes a solution that will let the people work to make it happen, using federal support as a catalyst for a much larger tidal wave of leveraged action. We will be able to preserve more land for less money and keep 100% of the land in the hands of the private land owner.

Mr. Chairman and Committee members, I thank you for your consideration and for allowing me to testify regarding this bill.

Chairman MCCRERY. Thank you, Mr. Isakson. Now the gentleman from Connecticut, Mr. Larson.

STATEMENT OF THE HONORABLE JOHN LARSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Mr. LARSON. Thank you, Chairman McCrery and Ranking Member McNulty, for this opportunity to appear before the Committee on Ways and Means and discuss the exemption of tax abatements and other local incentives on our volunteer services, most notably firefighters, police, and emergency medical services. I seek the Committee's unanimous consent to revise and extend, submit extraneous materials and supportive data with regard to my testimony.

[The information was not received at the time of printing.]

Chairman MCCRERY. Without objection.

Mr. LARSON. Thank you, Mr. Chairman. The genesis of this bill comes from local volunteer firefighters. Chief Crombie out of South Windsor approached me more than a year and a half ago now explaining a problem that local volunteers were having. South Windsor is not unlike many communities across this country, where there is considerable problems with both recruitment and retention of volunteers, especially firefighters and emergency medical services. Many States, including my own like Connecticut, local legislative bodies enacted incentives. Unfortunately, the Internal Revenue Service (IRS) in a court decision decided to strike those down, and in this case, in the case of South Windsor, treated a tax abatement as income. What is worse is that the workers, because they don't receive cash, the employer, in this case the municipality, is required to pay both portions of the Federal Insurance Contributions Act tax, therefore making it almost impossible for the local municipality to reach out and get the kind of recruitment and retention that they need.

This has a compounding effect, especially since International Fire Chiefs Association has noted that over the last 10 years we have seen a decline in volunteerism and largely over these very issues of recruitment and retention. There isn't a municipality in any one of our States that doesn't face these concerns on a regular basis. So, we put forward this legislation. We thought that there might be an administrative process, but in writing the U.S. Department of the Treasury, they responded by saying that they would prefer that we go the legislative route with exemptions. What the bill does very simply is provide exemptions not only in the case of a tax abatement but provides both local autonomy and flexibility, local autonomy for the municipality and flexibility for the States, so that they might include other incentives such as stipends, pay-per-call, health care, retirement incentives, State income tax credits, or death benefits, thereby leaving the decisions up to the States and also not allowing the IRS to reach into local coffers.

In seeking a cost estimate to this, we have yet to receive those. However, it is my contention and my opinion that this bill simply prohibits the IRS from claiming new revenue sources, or in essence prevents them from reaching into local tax coffers as they try to address their concerns and their needs with recruitment and retention of volunteers. The urgency, I think, is paramount. It wasn't lost on any Member of this body in response to September 11 that it wasn't the Federal Bureau of Investigations, the Central Intelligence Agency, or the Armed Services that responded in New York City, here at the Pentagon, or in the fields of Pennsylvania. It was local firefighters, emergency medical teams, and police. We should be doing everything within our power to make sure that we are empowering local municipalities to make sure that they are able to continue to recruit and retain these valuable citizens in our communities. Passage of this legislation where a companion bill has been introduced in the House would address an urgent concern needed in each and every one of our States and municipalities. Again, I thank the Chairman and the Ranking Member and the distinguished Members of this Committee for providing us an opportunity to bring this very urgent and timely request before you, and we hopefully will receive a favorable response.

[The prepared statement of Mr. Larson follows:]

Statement of The Honorable John Larson, a Representative in Congress from the State of Connecticut

Mr. Chairman, I would like to thank the Subcommittee for the opportunity to speak today on H.R. 1859, a bill I introduced to exempt local property tax abatements or other local incentives for volunteer emergency responders from federal taxation.

The bill was first introduced in 2002 after South Windsor Volunteer Fire Department Chief Phil Crombie, Jr., the Town of South Windsor and other volunteer emergency responders in my district alerted me to the fact that the tax abatements provided by local governments to volunteer firefighters as recruitment and retention incentives was being taxed by the IRS. In response, I immediately held a forum in my district to meet with community leaders and volunteer emergency responders to solicit ideas and input about how to best address this problem. The bill, H.R. 1859, reflects the valuable input I received at these sessions and subsequent discussions and responds directly to the needs and concerns of the emergency responders in my district, the State of Connecticut, and across the country.

There is no doubt that volunteer emergency responders play one of the most critical roles in ensuring the safety and security of our communities. In many areas across the country, they are the only responders for fire, medical, natural disasters, terrorist attacks and other community emergencies. In nearly all these situations, volunteers represent our nations first response, and in many cases, our first defense. In this time of heightened concern over the security of our homeland and the threat that terrorists pose to our communities, we cannot afford to lose these valuable and critical volunteers. Alarmingly, however, that is exactly what happened in volunteer fire departments nationwide in the past two decades.

A recent report by the International Association of Fire Chiefs (IAFC) found that the number of volunteer firefighters dropped ten percent since 1984, from a high that year of 880,000 to 790,000 in 2001. While an October 2003 survey by the National Volunteer Fire Council found that the number of volunteers had increased by about four percent between 2001 and 2002, it is clear that more must be done to help volunteer departments reverse the damage done by 20 years of decline in their ranks.

According to the IAFC, this decline "stems from both difficulties in retaining current volunteers as well as problems with recruiting new volunteers." To address these issues, and to provide cities and towns with greater retention and recruitment tools, the State of Connecticut passed a law in 1999 (Public Act 99–272) which allowed local governments to abate the property taxes of any resident who volunteers his or her services as a firefighter, emergency medical technician, or ambulance driver in their town. Many other states passed similar measures.

However, as cities and towns tried to enact local ordinances to take advantage of this law, the Internal Revenue Service (IRS)—in a separate property tax abatement case—ruled that under current federal law the amount of property tax abated for volunteers was considered "income" subject to federal taxation. Even worse, since the workers do not actually receive "cash" for these "wages," the "employer" (i.e. localities) would be required to pay *both* portions of the FICA tax on the amount of property tax abated, and would be subject to an *additional* FICA tax if the localities do not seek reimbursement from the volunteers for their portion of the FICA tax.

This decision clearly undermines the purpose of providing incentives for individuals to volunteer their time to keep their communities safe and imposes IRS control and influence into local government tax policy. In light of this ruling, many towns were forced to repeal their abatement incentives, or prevented from even considering such programs.

For example, the town of South Windsor was one of the first in Connecticut to enact a property tax abatement incentive for their volunteer emergency responders. Their $1,000 abatement clearly had an effect: after the law passed, 12 individuals joined the town's volunteer fire department, where only five had joined the year before. Despite this success, the town was forced to repeal their property tax abatement ordinance after the IRS ruling because it was simply impossible to reconcile their programs with existing federal tax law.

After 9/11, President Bush rightly called on Americans to volunteer their time in service to their neighbors, community and their nation. However, in today's economy where men and women must work longer hours or multiple jobs just to break even, finding the time to volunteer is in danger of becoming a thing of the past. These types of creative incentives help encourage new volunteers to strengthen the ranks of volunteer first responders, and provide important retention incentives.

Last February, I sent a letter signed by the Connecticut delegation to President Bush urging him to order an administrative stay on the IRS's ruling. In response, the Treasury Department advised that exempting property tax abatements from income and wage withholdings would best be accomplished through legislative, rather than administrative, means. To this end, I introduced legislation in the 107th and 108th Congresses to clarify the status of local tax abatements and other incentives for recruitment and retention offered by local governments to volunteer emergency responders under IRS rules. The current bill, H.R. 1859, has received the support of 25 Members of Congress, and a companion bill has been introduced in the Senate. In addition, the Connecticut Attorney General and the Town of South Windsor both strongly support this initiative.

Although this bill specifically exempts property tax abatements, it also allows local governments the flexibility and creativity to design their own incentive programs. For example, in addition to tax abatements, local governments across the country have experimented with providing modest stipends that are sometimes paid per call or in lump-sums per year or quarter, health benefits, retirement awards, state income tax credits or death benefits.

Rather than creating a specific list of benefits and eligible volunteer emergency responders, H.R. 1859 provides maximum local flexibility to design and implement the type of recruiting and retention incentive programs that reflect the needs of their communities and volunteers by exempting those benefits "provided by a State or political subdivision on account of services performed as a member of a qualified volunteer emergency response organization."

This approach ensures that the federal government does not mandate the types of incentive programs that can be established while also ensuring that States and local governments must first approve and adopt appropriate incentive programs and structure through their own legislatures. H.R. 1859 protects the prerogative of state and local governments to use their own local tax revenue as they see fit by prohibiting the IRS from claiming local tax dollars as new federal revenue streams.

I also wrote to the Joint Tax Committee last June and requested a revenue estimate to determine the "cost" to the federal government. However, to this date we have not gotten a response from the committee. Regardless of whatever "rules" they use to evaluate this proposal, it is my opinion that this bill simply prohibits the IRS from claiming new revenue sources, rather than taking away existing revenue sources and keeps the IRS from reaching into local tax coffers.

The urgency of this matter is clear. At a time when our communities increasingly rely on volunteers to respond to fire, medical and other emergencies, local governments must be allowed to provide creative incentives to those willing to serve their communities without interference from the IRS.

Thank you, and I look forward to working with the Ways and Means Committee and my colleagues in Congress in addressing this critical issue for our nation's volunteer emergency responders.

Chairman MCCRERY. Thank you, Mr. Larson. Well, we have had a Yale study submitted and now we are getting double teamed from Connecticut. Our next presenter is Mr. Simmons, also from the State of Connecticut. Mr. Simmons, you may proceed.

STATEMENT OF THE HONORABLE ROB SIMMONS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Mr. SIMMONS. Thank you, Mr. Chairman. Because my colleague and friend Congressman Larson has done such as excellent job, I will ask that my full statement be introduced into the record as if read.

Chairman MCCRERY. Without objection.

Mr. SIMMONS. Then I would like to summarize it. First of all, the State of Connecticut has 169 municipalities. In my district, the Second Congressional District, we have 65 towns. These tend to be rural, agricultural, small towns. We have no county government. I repeat, we have no county government. We have town government. Who provides emergency services and firefighting for those towns? By and large, volunteers. Because of the great job they do, and because it is harder and harder to get volunteers to provide these services, the State of Connecticut in 1999 passed the law allowing the municipalities, allowing these towns by ordinance to establish property tax relief as kind of a benefit to these volunteers. I voted for that law. I was in the legislature at that time; it is a good law, and it helps us with our 65 towns to attract and keep volunteers. It gives them a little benefit.

Well, lo and behold, what happens? The IRS comes in and says that this little benefit is taxable income, essentially taxable income. So, what do the towns do? Well, in some cases the towns wrestle with the paperwork for a while; in other cases they just give up. It is too complicated, it is too difficult to do. Again, these are small towns. So, this benefit which we as citizens of our State try to extend to our volunteers and emergency services and firefighting, this benefit has now been essentially taken away by the Federal Government, and I think that is wrong. I think it is wrong in principle, I think it is wrong at a time when we rely on our firefighters and our emergency service personnel more than ever to deal with issues of homeland security. I think it is wrong at a time when the President has urged more Americans to volunteer their time to their communities and their country, and where he is trying to stimulate volunteerism, which is what I understand is coming out of the White House. So, again, I commend my colleague, Mr. Larson. He has done a great job of bringing this legislation forward. I think there are probably other of our colleagues and other States that suffer from the same problem, and we thank the Chair and the Committee for considering this important proposal.

[The prepared statement of Mr. Simmons follows:]

Statement of The Honorable Rob Simmons, a Representative in Congress from the State of Connecticut

Mr. Chairman, thank you for the opportunity to testify before your Committee today. Mr. Chairman, I represent the 2nd District of Connecticut. The 2nd District constitutes half of the land mass of the state of Connecticut; approximately the entire eastern half of the state. It is a very rural district. What's more, it is a district made up of 65 towns. That is 65 autonomous municipalities—we do not have county government in Connecticut.

Mr. Chairman, the vast majority of my district is served by volunteer firefighters and emergency workers. The safety and security of my constituents depends on their own neighbors sacrificing *their* time to protect the community.

To thank these citizens for their service and to encourage others to serve, Connecticut passed a law in 1999 allowing municipalities to establish by ordinance a program to abate property taxes due for any fiscal year for a resident of the municipality who volunteers his or her services as a firefighter, emergency medical technician, or ambulance driver in the municipality.

Unfortunately, Mr. Chairman, this small benefit for Connecticut's volunteer first responders is now in jeopardy. In 2002, the IRS ruled that individuals receiving such property tax abatements must report the abatement as taxable income when filing their income taxes—effectively wiping out their local tax break.

What's more, this ruling has forced the small towns offering these abatements to grapple with daunting amounts of paperwork and red tape from the IRS. Understandably, some have—instead of confronting the vagaries of federal tax law—simply scrapped this compensation altogether.

Mr. Chairman, the federal government should be rewarding those who volunteer their time and resources to serve their communities, not punishing them with higher taxes.

To address this issue, I joined with my colleagues from Connecticut to urge President Bush to order an administrative stay of the IRS ruling. I'm also an original co-sponsor of legislation, H.R. 1859, introduced by my friend Rep. John Larson (D–CT) that would specifically exempt the compensation given to local volunteer emergency responders from being considered taxable income by the IRS. To date, the President has not blocked the ruling nor have we acted on Rep. Larson's bill.

Mr. Chairman, Connecticut's volunteer first responders are not the only ones being adversely affected by this IRS ruling. Other states have passed similar legislation to allow their municipalities to offer abatements.

And for good reason. The United States Fire Administration reports that nearly 75% of fire departments in America are staffed by volunteers, while the National Volunteer Fire Council estimates that these volunteers save localities $37 billion in funds not spent on full-time firefighters and emergency personnel.

Individuals who step forward to fill these positions are what I call "citizens in action," Mr. Chairman. Their commitment to serve benefits the community in two ways. First, it saves their municipality thousands of dollars that they would otherwise have to expend on a full-time staff of firefighters and other emergency personnel. Second, and more important, they can literally mean the difference between life and death to their fellow citizens when disaster strikes.

When people like my constituent Thomas Main of Bozrah, Connecticut sacrifice of themselves to protect their neighbor—and save their town thousands of dollars in the process—the least we can do is offer them a small break on their taxes. Whether they are firefighters, emergency medical technicians, or ambulance drivers, they are all heroes in my book. Lets show our appreciation to them and get the IRS off their back and out of their wallets.

Thanks again, Mr. Chairman, for allowing me to testify today on this important issue.

Chairman MCCRERY. Thank you, Mr. Simmons and Mr. Larson. Excellent presentation, and it is something that I am sure we will take a look at. Next on our agenda is the Representative from South Carolina, Mr. Wilson. Welcome. You may proceed.

STATEMENT OF THE HONORABLE JOE WILSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH CAROLINA

Mr. WILSON. Chairman McCrery, Ranking Member McNulty, Members of the Subcommittee, I would like to thank you for the opportunity to be here today to testify in support of my legislation, H.R. 2822, to modify the accumulated earnings tax. My interest in this particular tax derived actually from a corporate citizen of the district that I represent, and I think you all recognize Bose Corporation. We are very pleased that in the district that I represent they employ 1,200 people. They have just concluded investing $15 million into upgrading the manufacturing of the new compact disc version of the Bose, which is available immediately for you after the presentation. Additionally—this is such an important company. They export to 42 nations from the facility in South Carolina. My interest also has been piqued because this is a model corporation of the significance of the Indian-American population in the United States. Dr. Amar Bose, there is an article that I wanted to submit from Fortune Magazine this month. The Indian American population has been so significant in providing opportunities of employment for people of the United States. I am very proud as the Co-Chair of the Indian Caucus to point that out. Additionally, I have a commitment from the company that I would like to point out or submit along with questions for the record.

[The information was not received at the time of printing.]

A final point. I served as a real estate attorney for 25 years until I was fortunate enough to join you 3 years ago, and part of my service was to advise small businesses in the formation of their companies, and this directly relates. So, I had only wished that I worked with companies that would grow to the size of $1.7 billion. That is what we have in front of us. To briefly summarize, this legislation permits the corporations to accumulate earnings after taxes to protect—and this is accumulated earnings tax—against normal business fluctuations and unforeseen contingencies without fear of being subject to a Draconian penalty of the accumulated earnings tax. The legislation does not allow a corporation to avoid its liability for the corporate income tax; rather, it allows a corporation to save its earnings after it pays its taxes. Most important, it provides clear guidelines as to the amount of savings it can retain so that the IRS or the courts cannot later use a later standard in determining whether the corporation had the proper amount of savings.

By enacting H.R. 2822, Congress would amend the tax laws to provide a clear and unambiguous safe harbor for the appropriate accumulation of earnings after taxes. Ideally, Congress should repeal the accumulated earnings tax. It discriminates against successful entrepreneurs who created businesses prior to the advent of the limited liability company. That is not really feasible at this time. Since the current fiscal situation appears to prevent repeal of the accumulated earnings tax, we must at least make it more reasonable. The situation before us, the amount of working capital that a corporation can maintain has been frozen by outdated cases that were decided close to 40 years ago. These historic precedents do not take into account the dynamic economy today. Although our economy is evolving and changing, these antiquated court precedents and regulations remain. I urge the Committee to act favorably on H.R. 2822. We need to prevent the accumulated earnings tax laws from being a barrier to sensible business planning, including planning for unforeseen contingencies. Mr. Chairman, Members of the Committee, I truly appreciate the opportunity to appear before you today, my first opportunity, and I would welcome any questions. Thank you very much.

[The prepared statement of Mr. Wilson follows:]

Statement of The Honorable Joe Wilson, a Representative in Congress from the State of South Carolina

Thank you for the opportunity to testify in support of H.R. 2822.

Enactment of this legislation is necessary to permit corporations to accumulate reasonable and sufficient funds to protect against normal business fluctuations and unforeseen contingencies without fear of being subject to the draconian penalties of the accumulated earnings tax. If Congress fails to pass this legislation, the tax law will continue to threaten prudent corporations with a confiscatory accumulated earnings tax.

Let us be clear. This legislation does not allow a corporation to avoid its liability for the corporate income tax. Rather, it allows the corporation to save its earnings after it pays its taxes. Most important, it provides clear guidelines as to the amount of savings it can retain, so that the IRS or the courts cannot later use a different standard in determining whether the corporation had the proper amount of savings.

By enacting H.R. 2822, Congress would amend the tax laws to provide a clear and unambiguous safe harbor for appropriate accumulation of earnings. Specifically, H.R. 2822 would create a safe harbor that would take into account the size of the business being conducted and its historical need for earnings. It would allow a corporation to retain, at a minimum, sufficient earnings to cover the significant costs and expenses it incurred in conducting its business during the prior year. A corporation could always accumulate additional earnings if it could satisfy the requirements of present law with respect to those earnings. Enactment of H.R. 2822 would, however, prevent the IRS or the courts from imposing a penalty for an accumulation of earnings that is less than or equal to the significant costs and expenses that the corporation incurred in conducting its business during the prior year.

Ideally, Congress should repeal the accumulated earnings tax. It discriminates against successful entrepreneurs who created businesses prior to the advent of the limited liability company. It discourages exactly the behavior that the competitive market and our national interest should be encouraging. We live in an age when businesses can survive only by accumulating significant resources both to be able to weather rapid changes in the marketplace and to invest in new products to meet changing consumer demand. Instead of facilitating such behavior, the accumulated earnings tax perversely threatens draconian tax penalties on corporations that are accumulating profits for uncertain future needs.

If the fiscal situation prevents a repeal of the accumulated earnings tax, we must at least act to make it more reasonable. A corporation should not be threatened with the application of a penalty tax unless Congress has at least provided a clear and objective safe harbor that allows a reasonable amount of earnings to be accumulated. The need for a clearly-stated objective standard is obvious. In the absence of some safe harbor, the uncertainty in the current law, when combined with the draconian nature of the accumulated earnings tax, essentially forces corporations to minimize the accumulation of earnings that might be needed to withstand unexpected adversity.

Even worse, the accumulated earnings tax allows the IRS and the courts to second guess a corporation's business judgments and decisions. Revenue agents and judges who do not have experience with the uncertainties of business should not be able to use hindsight years later to belittle the risks of what were, at the time, uncertain business exigencies. At a minimum, Congress must circumscribe the complete flexibility of Congress and the courts by providing a safe harbor on which corporations can rely.

The absence of a safe harbor also imposes unnecessary costs on our businesses that operate in corporate form. By eliminating the need for a corporate taxpayer to retain lawyers and accountants to prepare voluminous documentation about potential uses for the earnings, corporations would not be incurring significant unnecessary costs merely to maintain a reasonable buffer against potential changes in the market.

Unfortunately, neither the IRS nor the courts are attempting to remedy the situation. The Treasury Regulations allow a corporation to retain sufficient funds for future needs of the business for which the corporation has "specific, definite and feasible plans" and for working capital. Accumulation of earnings for future needs that are uncertain or vague, or future uses that are not specific, definite, and feasible are not permitted. Although competing effectively requires businesses to be opportunistic, to take advantage of unforeseen opportunities, and to adjust to unforeseen competitive challenges, the current regulations penalize a corporation for maintaining the resources to do so.

In addition, the amount of working capital that a corporation can maintain has been frozen by outdated cases that were decided close to forty years ago but still serve as controlling authority. These historic precedents do not take account of the dynamic economy of the present day. In particular, the existing court precedents define working capital needs as only the cash that is required for a single turnover cycle and do not take into account unanticipated contingencies, such as a rapid change in product demand or technology that require rapidly incurring costs. These contingencies are likely to arise with greater frequency than previously as a result of a rapidly changing economy, shorter product life cycles, and greater competition, including competition from outside the United States.

Although the U.S. and the world economy are evolving and changing, these antiquated court precedents and regulations remain. As a result, the accumulated earnings tax is preventing sensible planning for working capital needs and has become a burden to U.S. businesses that are trying to compete. Even worse, these outdated standards threaten to penalize a corporation for maintaining sufficient working capital to carry it through adverse circumstances or sufficient resources to allow it to take advantage of competitive opportunities.

I urge the Committee to act favorably on H.R. 2822. We need to prevent the accumulated earnings tax laws from being a barrier to sensible business planning, including planning for unforeseen contingencies.

I appreciated this opportunity to address the Committee and would welcome any questions. Thank you.

Chairman MCCRERY. Thank you, Mr. Wilson. Next the gentleman from Ohio, Mr. Turner. By the way, we will allow the Committee to ask questions when all the panel members have completed their testimony. Mr. Turner.

STATEMENT OF THE HONORABLE MICHAEL TURNER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. TURNER. Thank you, Chairman McCrery, and Ranking Member McNulty, and Members of the Subcommittee. Thank you for the opportunity to testify considering the Brownfields Revitalization Act of 2004 (H.R. 4480). I would also like to thank my Ohio colleague, Stephanie Tubbs Jones, for assistance in the opportunity to testify before the Subcommittee, and thank her as an original cosponsor of the legislation that I will address in my remarks. I greatly appreciate her leadership in the area of brownfield redevelopment. Mr. Chairman, before being elected to Congress, I served for 8 years as the Mayor for the City of Dayton, where my top priority was urban revitalization and economic development. The City of Dayton is not unlike many of America's center cities that continue to struggle economically. In most of urban America tax revenues are declining and jobs are leaving. Although many center cities are inventing wonderfully creative programs to achieve revitalization, they are hindered by the very thing that makes them unique: density. The availability of land is an enormous impediment to the economic renewal and revitalization of cities. Yet there is a solution to this predicament.

American cities hold acres of abandoned land that could be and should be redeveloped as a key ingredient to urban recovery. These abandoned properties include former factories and other contaminated sites. These sites are called brownfields. Brownfields are defined as abandoned or underutilized properties, such as old factories, where expansion or redevelopment is complicated by environmental contamination. These properties are found in every State and in every congressional district. Estimates range from a half a million to 1 million brownfield sites nationwide, covering at least 178,000 acres, or roughly the combined land area of Seattle, Atlanta, and San Francisco. These sites are missed economic development opportunities. Based on a survey of 205 cities, the U.S. Conference of Mayors estimates that redevelopment of brownfields located in our cities could generate more than 575,000 new jobs, and that renewed activity could actually bring in as much as $1.9 billion annually in new tax revenues for the cities surveyed. House Resolution 4480, the Brownfields Revitalization Act of 2004, provides a Federal program to encourage redevelopment by providing funding for demolition and environmental remediation costs.

Specifically, the proposed brownfields tax credit program would provide $1 billion in Federal tax credits allocated to the States according to population. The credit program would be administered by State development agencies and would provide credits to brownfield projects where the local government entity includes a census tract with poverty in excess of 20 percent. The redevelopment project may be located anywhere within a qualifying local jurisdiction. Brownfield tax credits would be allocated for up to 50 percent of demolition and remediation costs pursuant to an approved plan. These credits would be transferable and could be sold to third parties. The proceeds of the sale would be nontaxable. The remainder of cleanup costs could be deductible or may be capitalized by the property owner, and the plan also includes incentives for original polluters to participate in the redevelopment. Parties potentially responsible for cleanup costs that contribute no less than 25 percent of the environmental remediation costs would receive liability releases for 100 percent of approved demolition and remediation costs. This program would constitute a powerful incentive to transform derelict brownfield sites into job producing economic development. Without a federally created program, brownfields remain, marring the face of U.S. cities. Redeveloping brownfields will revitalize our cities, returning them to the life and vitality once seen when these sites provided jobs and were anchors for our neighborhoods and communities. The bill has been endorsed by the American Institute of Architects, the U.S. Conference of Mayors, the National Home Builders Association, and has support by the members of the real estate roundtable. Thank you.

[The prepared statement of Mr. Turner follows:]

Statement of The Honorable Michael Turner, a Representative in Congress from the State of Ohio

Chairman McCrery, Ranking Member McNulty and Members of the Subcommittee, thank you for the opportunity to testify concerning the Brownfields Revitalization Act of 2004—H.R. 4480. I would also like to thank my Ohio colleague Congresswoman Stephanie Tubbs Jones for her assistance in allowing me to testify before the Subcommittee, and thank her as an original co-sponsor of the legislation that I will address in my remarks—I greatly appreciate her leadership in the area of brownfield redevelopment.

Mr. Chairman I understand that many of my colleagues will address the Subcommittee today about key tax issues that are important to their constituents. Before being elected to Congress I served for eight years as the Mayor of the city of Dayton, Ohio where my top priority was urban revitalization and economic development. The city of Dayton is not unlike many of America's center cities that continue to struggle economically.

In most of urban America, tax revenues are declining and jobs are leaving. Although many center cities are inventing wonderfully creative programs to achieve revitalization, they are hindered by the very thing that makes them unique: density. The availability of land is an enormous impediment to the economic renewal and revitalization of cities.

And yet, there is a solution to this predicament. American cities hold acres of abandoned land that could be—should be—redeveloped as the key ingredient to urban recovery. These abandoned properties include former factories and other contaminated sites. These sites are called brownfields.

Brownfields are defined as abandoned or underutilized properties, such as old factories, where expansion or redevelopment is complicated by environmental contamination. These properties are found in every state and every congressional district.

Estimates range from 500,000 to 1 million brownfields sites nationwide, covering at least 178,000 acres, or roughly the combined land area of Atlanta, Seattle, and San Francisco. These sites are missed economic development opportunities. Based on a survey of 205 cities, the U.S. Conference of Mayors estimates that redevelopment of the brownfields located in these specific cities, could generate more than 575,000 new jobs, and that renewed economic activity could bring in as much as $1.9 billion annually in new tax revenue for the cities surveyed.

Local officials, developers and environmentalists all consider brownfields a federally created problem in that under current law, a property owner may be fully responsible for all costs to remediate environmental problems once those problems are identified. One unintended consequence of the current environmental laws is that properties with suspected contamination are abandoned to avoid potential liability for high cleanup costs. The end result is that brownfields remain marring the face of our communities, and impeding economic development, and job creation.

H.R. 4480, the Brownfields Revitalization Act of 2004, provides a federal program to encourage redevelopment by providing funding for demolition and environmental remediation costs. Specifically the proposed Brownfields Tax Credit Program would provide $1 billion in federal tax credits allocated to states according to population. The credit program would be administered by state development agencies, and would provide credits to brownfield redevelopment projects where the local government entity includes a census track with poverty in excess of 20%. The redevelopment project may be located anywhere within a qualifying local jurisdiction.

Brownfields tax credits would be allocated for up to 50% of demolition and remediation costs pursuant to an approved plan. These credits would be transferable and could be sold to third parties. The proceeds of the sale would be non-taxable. The remainder of cleanup costs would be deductible or may be capitalized by the property owner, and the plan also includes incentives for original polluters to participate in redevelopment. Parties potentially responsible for clean up costs that contribute no less than 25% of remediation costs receive liability release for 100% of approved demolition and remediation costs. The remaining 25% of remediation costs could be paid by either the property owner or other state or local government entities.

The Government Accountability Office (GAO) is currently conducting a review of EPA's Brownfields Program that Chairman Davis of the House Committee on Government Reform and I requested. Although GAO's final report on its findings will not be available until December, GAO staff has briefed me and my staff on their preliminary findings on several occasions. In the course of its work, GAO spoke with over 30 individuals and groups covering a wide range of stakeholders, including EPA, state and local government agencies, national groups with brownfields expertise, EPA brownfields grant recipients, real estate developers, property owners, attorneys, and nonprofit organizations. It's my understanding that—while GAO did not fully analyze the costs and benefits of a federal tax credit—the majority of these stakeholders believe that a federal tax credit, which would allow developers to offset a portion of their federal income tax with their remediation expenditures, could complement EPA's Brownfields Program by attracting developers to brownfields on a broader national basis. Some of these stakeholders said that tax credits are an easily understandable and tangible incentive to the private sector and noted that other, similar tax credits—such as the affordable housing and historic preservation credits—have proven effective in stimulating redevelopment.

Similarly, Cherokee Investment Partners, a private equity fund that acquires, remediates and revitalizes brownfields, supports H.R. 4480. Cherokee agrees that a transferable tax credit will help make revitalization and development viable for many of the sites where the high level of risk and cost of remediation make redevelopment unattainable.

This program would constitute a powerful incentive to transform derelict brownfields sites into job-producing economic development. Without a federally created program, brownfields will remain, marring the face of U.S. cities. Redeveloping brownfields will revitalize our cities, returning to them the life and vitality once seen when these sites provided jobs and were anchors for our neighborhoods and communities.

Chairman MCCRERY. Thank you, Mr. Turner. Last on our beginning panel today but certainly not least, the Representative from Missouri, the gentle lady Ms. McCarthy.

STATEMENT OF THE HONORABLE KAREN MCCARTHY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MISSOURI

Ms. MCCARTHY. Thank you very much, Mr. Chairman, and also to Ranking Member McNulty and the Members of the Subcommittee, several of whom are co-sponsors of this legislation. The purpose of H.R. 4736, the Independent Films Small Business Job Creation Act, is to help create jobs in the United States by encouraging investment in film production here at home. The U.S. Department of Commerce report released earlier this year estimates that runaway production drains as much as $10 billion per year from the United States, as the entertainment industry foregoes the United States and chooses to make motion pictures, television shows, and commercials abroad. This exodus to foreign countries or runaway production affects American workers and the American economy. Between 1990 and 1998, it is estimated that the number of U.S. films made abroad doubled from 14 percent to 27 percent. Tens of thousands of artists and craftspeople have lost wages, health care benefits, their homes, and their dignity as a result of this continuing problem. Dramatic State revenue deficits inspired Governors Schwarzenegger of California, Bush of Florida, Pataki of New York, and Perry of Texas to co-sign a letter urging Congress to take action on this critical issue to their State's economy.

The directors of the Missouri Film Commission have received calls from film makers in Montreal and Toronto requesting our Missouri signage, newspaper, and license plates to give the appearance of Missouri for film productions being shot in Canada. Director Ang Lee's movie Ride with the Devil, a $38-million film about the Civil War, was shot in Missouri; but, conversely, I know that Missouri lost the Angelina Jolie production, Life or Something Like It, because tax incentives utilized in Canada lured the producers to shoot the movie there. Missouri, a State that has lost 34,000 jobs since January, could have greatly benefited from that production. It is estimated the economic multiplier effect of every dollar spent on film production yields a $2 to $5 return to the community. A Missouri economic study showed that the movie, The Game of Their Lives, which was shot in Saint Louis, provided a $21-million stimulus to the State of Missouri. That production and the opportunity that it represents was nearly lost to Canada. It is ironic, but Little House on the Prairie is being shot in Canada currently.

House Resolution 4736 is supported by the Screen Actors Guild among others in the industry. It encourages domestic film investment by allowing investors to expense their investment in the percentage that is spent by the production company each year. The deduction is available to investment on film productions that have budgets greater than $2 million but less than $20 million. That would indicate independent film making. So, long as 95 percent of the budget is spent in the United States. In summary, this bill would address runaway productions by encouraging investment in independent film projects in the United States. Many of the business opportunities created by film production are in local businesses like catering, car services, printers, special effects, and sound technicians, telecommunication vendors, retail stores, carpenters, painters, stage hands, and dry cleaners. Missouri, Massachusetts, New York, Texas, Florida, Illinois, Arizona, North Carolina, Utah, Washington, Nevada, and California are increasingly dependent on film productions as major contributions to their economies. However, foreign countries following the lead of Canada, that being Australia, England, and France, are now providing incentives to lure U.S. productions to their countries. Using standard economic formulas to calculate the multiplier effect, each new $10-million film project will yield $35 million in ripple effects locally as a stimulus. Chairman McCrery and Ranking Member McNulty and Members of the Committee, thank you again for this opportunity to discuss important legislation. This bill will create jobs locally and stimulate local economies across our Nation and continue a great U.S. tradition of excellence in the world of film making. Thank you very much.

Chairman MCCRERY. Thank you, Ms. McCarthy. Before we go to questions, I want to recognize for unanimous consent request a Member of the Subcommittee, Mr. Sandlin.

Mr. SANDLIN. Thank you, Mr. Chairman, for recognizing me. I know the Chairman is very interested in energy issues, and I would like to submit for the record a statement from Charlie Stenholm, a Representative from Texas. He is asking that we move forward with energy legislation and include the wind energy production tax credit in the All American Tax Relief Act. So, I would like to submit his written statement for the record.

Chairman MCCRERY. Without objection.

Mr. SANDLIN. Thank you.

[The prepared statement of Mr. Stenholm was not received at the time of printing.]

Chairman MCCRERY. I thought all of you did an excellent job laying out for the Subcommittee your ideas on how to improve the Tax Code, so I don't have a lot of questions because I thought you did such a good job of explaining your point of view. Mr. Wilson, though, I can't pass up the opportunity to ask you the question: why should corporations not be taxed on their accumulated earnings? I mean, what would they do with that money that they save from not having to pay the taxes?

Mr. WILSON. Well, they still would be taxed on it.

Chairman MCCRERY. They pay their initial income tax.

Mr. WILSON. Then what would happen is that, because it has become a moving target how much can be accumulated, what we are proposing is that it be a percentage so that IRS and so that courts and businesses would know what the number is. So, it is a modification. In particular, it also addresses a concern in that foreign corporations don't have this problem. Then, in particular, Bose is unique in that indeed they put their earnings back into research and development, and that is indicated in the article that I mentioned from Fortune Magazine. So, this is really to still provide for the taxation, but it is to make specific as to how much can be accumulated, which has been—according to the agent, virtually—and then trying to second guess how the corporation operates and where it is located and how many people it employs, and so it has made it virtually impossible to count on it.

Chairman MCCRERY. So, it would help them to carry out their business plan in a more orderly fashion?

Mr. WILSON. Yes.

Chairman MCCRERY. Dedicate that money to research and development or to increasing their sales force or whatever it might be in a timeframe that they deem appropriate.

Mr. WILSON. That is right. Obviously I am very interested in Bose, with the 1,200 employees in the district. The success of it. This would just simply enhance their ability for greater research and development. We are all so familiar with how extraordinary Bose products have been received around the world. Forty-two countries are receiving exports from our district, and we want to make it—let us see if we can make it to 50.

Chairman MCCRERY. Thank you. Ms. McCarthy.

Ms. MCCARTHY. Yes, Mr. Chairman.

Chairman MCCRERY. I am sure you have had conversations with the industry regarding your proposal. Do you have any evidence or any suggestion from your conversations with the industry that, if we were to make this change in the Tax Code, that the industry would respond favorably and bring more of their production onto our shores?

Ms. MCCARTHY. Yes, Mr. Chairman, and I would be glad to submit letters from organizations in the industry, like the Screen Actors Guild and others, for the record so that you have that documentation. Again, we are talking about independent films, and those are the ones that really do make a difference locally. This does not address Hollywood; they have their own incentives.

Chairman MCCRERY. Right. Well, thank you. Without objection, those materials will be inserted into the record.

Ms. MCCARTHY. Thank you.

[The information was not received at the time of printing.]

Chairman MCCRERY. Mr. McNulty.

Mr. MCNULTY. Thank you, Mr. Chairman. I want to thank each of the Members for their testimony. There are a couple of these proposals that I already intend to support, a couple of others I need to look at a bit further. I want to echo the Chairman's remarks that each of the Members did an excellent job in presenting their views to the Committee. With that, I wish to yield to Ms. Tubbs Jones.

Mrs. JONES. Thank you, Mr. Ranking Member, Mr. Chairman, my colleagues from across the United States. I want to commend you in the work that you are doing in this area. Unfortunately, we are at the end of the season for the 108th Congress, but I would encourage each and every one of you to join together and reintroduce much of this legislation in the 109th Congress. I want to commend my colleague from Ohio who will be appearing here today, Mr. Chairman, and for the record I seek unanimous consent to submit an opening statement. Thank you.

Chairman MCCRERY. Without objection.

[The opening statement of Mrs. Jones was not received at the time of printing.]

Chairman MCCRERY. Mr. Lewis.

Mr. LEWIS. I have no questions.
Chairman MCCRERY. Mr. Ryan.
Mr. RYAN OF WISCONSIN. None.
Chairman MCCRERY. Mr. Sandlin.
Mr. SANDLIN. No, sir, Mr. Chairman. Thank you.
Chairman MCCRERY. Mr. Collins.
Mr. COLLINS. No, sir.

Chairman MCCRERY. See, I told you, you did a great job. Thank you all very much for your testimony. Now would the second panel please come forward and take your seats? Okay. Welcome to the Subcommittee on Select Revenue Measures of the Committee on Ways and Means. It is nice to have you with us. We are expecting a couple more Members for this second panel. So, they will be coming in, but we will go ahead and start with the Members who are here. Just to reiterate, your written testimony will be included in the record in its entirety, but we would like for you to summarize your thoughts and proposals within 5 minutes. With that, we will begin with Mr. Neugebauer from Texas. Mr. Neugebauer.

STATEMENT OF THE HONORABLE RANDY NEUGEBAUER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. NEUGEBAUER. Thank you, Mr. Chairman. I am here today to discuss a very significant issue that is important not only, I think, to the people in the United States but it is certainly important to the people in my district of west Texas, and that is wind energy. In the 1960s, Bob Dylan wrote a popular song, "You don't need a weatherman to know which way the wind blows." Today the wind represents more than weather in west Texas; it means economic growth and renewable energy. Texas, particularly west Texas, has vast areas of land which have high wind power potential. Previous generations in this area relied on wind mills to pump water. Today, high-tech wind turbines as tall as the Statue of Liberty are producing megawatts of electricity, enough power to supply electricity to thousands of homes. The wind energy industry contributes directly to the economies of 46 States with power plants and manufacturing facilities that produce wind turbines, blades, electronic components, gear boxes, generators, and a wide range of other equipment. Wind farms can revitalize the economy of rural communities, providing a steady income through lease or royalty payments to farmers and other landowners, as well as property and school taxes to the local governments. Although leasing arrangements vary widely, a reasonable estimate for income to a landowner for a single utility-scale turbine is about $3,000 per year.

Wind farms may extend over a large geographic area, but their actual footprint covers only a small portion of the land, making wind development an ideal way for farmers to earn additional income. In west Texas, farmers and ranchers are welcoming wind, as lease payments from this new clean energy source replace declining payments for oil wells on the properties that have been depleted. Local governments are also welcoming wind. The county commissioners in Howard County, for example, in my district, have proposed issuance of industrial revenue bonds to an energy company interested in building another wind farm in the county. County officials estimate that this new wind farm will bring more than $700,000 to the county and other taxing jurisdictions, such as their local schools. Additional local income is generated from payments to construction contractors and suppliers during the installation and from payments to turbine maintenance personnel on a long-term basis. All of this sounds great, but how much does wind energy cost? The actual production of energy comes at a relatively low price. State-of-the-art wind power plants can generate electricity for less than 5 cents per kilowatt hour in many parts of the United States. Over the last 20 years, the cost of electricity from utility-scale wind systems has dropped more than 80 percent. However, the investment required to establish wind production farms runs in the millions of dollars. For example, a 160-turbine wind farm built in west Texas in 2003 cost more than $80 million.

The wind energy production credit is a key component in financing new wind energy projects. Without consistent government policy that creates a consistent business environment, investment slows and projects on the drawing board are put on hold. Wind energy producers need a tax policy consistency in order to develop accurate long-term business models, acquire land, and finance expensive construction. As you know, the production tax credit expired at the end of 2003, costing thousands of jobs and millions of dollars of wind power investments in States across the country, including Texas. I appreciate the work of this Subcommittee to advance the credit and energy bill and the American Jobs Creation Act, and most recently including it in the conference report in H.R. 1308, which is on the floor today. This credit is crucial to this young, growing industry. Wind energy projects require a lead time of 6 to 9 months, and expiration of the credit has stopped wind projects, and restarting projects will take time.

This slowdown has affected not only the wind energy producers, but their suppliers, their construction workers, and local governments. For example, Taylor County, Texas estimates that it lost $500,000 in annual revenue this year due to the postponement of construction of up to 200 new wind turbines in an area school district that has anticipated up to $1 million in taxes from this project. To make up for the lost revenue, the county had to raise their tax rates. Over the past 2 years, the wind industry has installed over 250,000 megawatts of new electric capacity, spurring more than $2.5 billion in economic activity. However, the expiration of the tax credit has resulted in the loss of 2,000 jobs already and 1,500 megawatts of new wind energy production and nearly $2 billion in economic activity on hold. As work continues on legislation to provide relief to American businesses, I believe that the wind energy production tax credit is a critical incentive that would further fuel economic growth and job creation in west Texas and the United States. I would say also that there are some out there that think that these credits maybe should be transferable as a way to also encourage investment in this very important renewable source of wind energy, and certainly I would encourage the Committee to look into that as we move forward with our energy policy and tax policy in the future. Thank you again, Mr. Chairman, for holding these hearings and for your allowing me to testify today.

[The prepared statement of Mr. Neugebauer follows:]

Statement of The Honorable Randy Neugebauer, a Representative in Congress from the State of Texas

Thank you, Mr. Chairman. I am here today to discuss a matter of significant importance to my district in West Texas—wind energy.

In the 1960s, Bob Dylan wrote the popular tune, "You don't need a weatherman to know which way the wind blows." Today the wind represents much more than weather; it means economic growth and renewable energy.

Texas, particularly West Texas, has vast areas of land with high wind power potential. Previous generations in this area relied on windmills to pump water. Today, high-tech wind turbines as tall as the Statue of Liberty are producing megawatts of electricity, enough power to supply thousands of homes.

As the oldest source of renewable energy, wind power supplies affordable, inexhaustible energy to the economy. It also provides jobs and other sources of income. Wind powers the economy without causing pollution, generating hazardous wastes, or depleting natural resources. Best of all, wind energy depends on a free fuel source—the wind—and so it is relatively immune to inflation.

The wind industry contributes directly to the economies of 46 states, with power plants and manufacturing facilities that produce wind turbines, blades, electronic components, gearboxes, generators, and a wide range of other equipment.

The Renewable Energy Policy Project (REPP) estimates that every megawatt of installed wind capacity creates about 4.8 job-years of employment, both direct (manufacturing, construction, operations) and indirect (advertising, office support, etc.). This means that a 50 megawatt wind farm creates 240 job-years of employment.

Wind farms can also revitalize the economy of rural communities, providing steady income through lease or royalty payments to farmers and other landowners, as well as property and school taxes to local governments. Although leasing arrangements vary widely, a reasonable estimate for income to a landowner from a single utility-scale turbine is about $3,000 a year.

For a 250-acre farm, with income from wind at about $55 an acre, the annual income from a wind lease could be $14,000, with no more than 2 or 3 acres removed from production. Such a sum can significantly increase the net income from farming. Farmers can grow crops or raise cattle next to the towers. Wind farms may extend over a large geographical area, but their actual "footprint" covers only a very small portion of the land, making wind development an ideal way for farmers to earn additional income. In West Texas farmers and ranchers are welcoming wind, as lease payments from this new clean energy source replace declining payments from oil wells on their property that have been depleted.

Local governments are also welcoming wind. The county commissioners in Howard County in my district have proposed issuance of industrial revenue bonds to an energy company interested in building another wind farm in the county. County officials estimate that a new wind farm would bring in more than $700,000 to the county and other taxing jurisdictions, such as local schools.

Additional local income is generated from payments to construction contractors and suppliers during installation, and from payments to turbine maintenance personnel on a long-term basis.

Investing in wind energy also makes us less dependent on foreign sources of energy. The American Wind Energy Association estimates that U.S. wind plants are already helping to reduce the national natural gas shortage by 10–15%. By encouraging new domestic energy exploration and investing in new energy infrastructure, we can improve our domestic energy security.

All of this sounds great, but how much does wind energy cost? The actual production of energy comes at a relatively low price. State-of-the-art wind power plants can generate electricity for less than 5 cents per kilowatt-hour in many parts of the U.S. Over the last 20 years, the cost of electricity from utility-scale wind systems has dropped by more than 80 percent. However, the investment required to establish a wind production farm runs in the millions of dollars. A 160-turbine wind farm built in West Texas in 2003 cost more than $80 million.

The wind energy production credit is a key component in financing new wind energy projects. Without a consistent government tax policy that creates a consistent business environment, investment slows and projects on the drawing board are put on hold. Wind energy producers need tax policy consistency in order to develop accurate long-term business models, acquire land and finance expensive construction.

As you all know, the productions tax credit expired at the end of 2003, costing thousands of jobs and millions of dollars of wind power investments in states across the country, including Texas. I appreciate the work of this Subcommittee to advance the credit in the energy bill, the American Jobs Creations Act, and, most recently, the proposal to include it in the conference report extending other expiring tax provisions.

This credit is so crucial to this young, growing industry. Wind energy projects require a lead time of six to nine months. Expiration of the credit has stopped wind projects, and restarting projects will take time. This slow-down has affected not only wind energy producers, but their suppliers, construction workers and local governments.

For example, Taylor County Texas estimates that it has lost $500,000 in annual tax revenue this year due to postponement of construction of up to 200 new wind turbines, and area school districts had anticipated up to $1 million in taxes from the projects. To make up for the lost revenue, the county has raised tax rates.

Lone Star Transportation of Ft. Worth is losing $1.5 million in revenue per month to the production tax credit delay. Last year the company earned $20 million—a full 20 percent of company revenues—by trucking wind turbine towers, blades and generating units to development site.

Over the last two years, the wind industry has installed over 2,500 megawatts of new electric capacity spurring more than $2.5 billion in economic activity. However, the expiration of the credit has resulted in the loss of over 2,000 jobs already and 1,500 megawatts of new wind energy production and nearly $2 billion in economic activity on hold.

As work continues on legislation to provide relief to American businesses, I believe that the wind energy production tax credit is a critical incentive that will further fuel economic growth and job creation in West Texas, and in the United States.

Chairman MCCRERY. Thank you, Mr. Neugebauer. Next we have from the State of Pennsylvania, the gentleman, Mr. Weldon, a classmate of mine, and a very outstanding Member of the Armed Services Committee. Welcome to the Committee on Ways and Means.

STATEMENT OF THE HONORABLE CURT WELDON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. WELDON. Thank you, Mr. Chairman, and Mr. McNulty, and Members of the Subcommittee. It is a pleasure to be here. The legislation I am here to support is H.R. 1824, the Fire Sprinkler Incentive Act. It is co-sponsored by 137 Members of the House, including 14 Members of this Committee on Ways and Means. It is perhaps the most significant legislation that we could pass to reduce the loss of lives in America each year. Each year, we lose almost 4,000 Americans to fires in everything from nursing homes to nightclubs to single family homes, and we lose these lives because they are not sprinklered. The National Fire Protection Association studies that have been done show that any building that is sprinklered has never had a multiple loss of life. So, we have never had a multiple loss of life by fire in any building that complies with the Life Safety and Sprinkler Code of the National Fire Protection Association. In addition to the loss of innocent civilians, we lose 100 firefighters each year who enter burning buildings to attempt to rescue people. Now, why aren't these buildings sprinklered? Most new building codes that are applied to new construction, whether it is in some cases residential, manufacturing, nursing homes, or other, require sprinkler protection. The problem, Mr. Chairman, is that many of our older nightclubs like the one up in Rhode Island where 100 people were killed because they were trapped inside the building and had no way out, most of them are frame construction, most of them have no protection systems whatsoever. They were grandfathered in by building codes and fire codes because they were built decades ago, and these are the most vulnerable facilities where we have the highest loss of life.

How then can we convince a nightclub owner, a nursing home owner, or a school to retrofit the building when it would cost so much money to put sprinklers in? The current rate of depreciation for installing sprinklers would take 39 years for recovery. Now, the insurance industry offers significant insurance premium reduction if sprinklers are installed. In fact, they go as high as 80 percent. If we pass the legislation I have before you, you decrease the depreciation from 39 years to 5 years, and if you take that increased depreciation, which can be used to recover the cost of the sprinkler, and you add to that the cost of the insurance savings, then a small business owner who runs a nightclub in a small town can put sprinklers in and recover the cost within 2 years. That is an incentive that anyone would jump at the opportunity. So, you are not forcing that nightclub owner to retroactively retrofit his facility, you are not mandating that nursing home to do it, but it becomes so logical and such a natural that everyone we are convinced would move forward to retrofit their buildings, because between the increased depreciation and being able to write off that cost in 5 years as opposed to 39, and the added reduction in insurance premiums, that we can put the systems in place that do protect lives.

Mr. Chairman, the 18 national associations from the American Insurance Association to the International Association of Firefighters, the International Association of Fire Chiefs, the National Volunteer Fire Council, all the major building alliances, all of them publicly on the record, as is stated in my statement, support this legislation. It makes sense. In the end, yes, it will reduce the amount of revenue that we receive. Mr. Chairman, it will increase the amount of savings for personal—for property loss, for industrial and commercial activity, and it will save significant amounts of lives. So, I encourage you to consider this. This is not a mandate, it is an opportunity, and it is an opportunity that I think will have an effect in every congressional district in America in a positive way by encouraging those institutions that have life safety risk, including homes, to install automatic sprinkler protection. Thank you.

[The prepared statement of Mr. Weldon follows:]

Statement of The Honorable Curt Weldon, a Representative in Congress from the State of Pennsylvania

Thank you for the opportunity to testify before the Committee on H.R. 1824, The Fire Sprinkler Incentive Act of 2003. Passage of H.R. 1824 would serve greatly to help reduce the tremendous annual economic and human losses that fire in the U.S. inflicts on the national economy and the quality of life. This bill currently has 137 cosponsors, 14 of which are members of the Ways and Means Committee.

From the time a fire begins, detection can be reported within the first 3 minutes. Once dispatched, firefighter response begins at 4 minutes, hoping to arrive on scene and setup for suppression within 10 minutes. During this time, the level of combustion has grown exponentially and leading to flashover two minutes earlier. Flashover is the level of combustion that engulfs the entire room in flames—an environment that no person can survive.

Meanwhile, the 70% of smoke alarms that are functional (30% do not work, mostly due to dead or non-existent batteries) have alerted building occupants to escape through pre-planned evacuation routes. Unfortunately, the elderly, unattended children and the mentally or physically disabled are often unable to do so.

This is not a dramatization. In fact, this scenario continuously occurs each year. In the U.S., fire departments responded to 1.7 million fires in 2001, 521,000 structural fires causing 3,745 fire deaths, 99 of whom were firefighters (not including those lost on September 11th). Fires also caused almost 21,000 civilian injuries and $8.9 billion in direct property damage. This translates to the fact that fire departments respond to a fire every 18 seconds. Every 60 seconds a fire breaks out in a structure and in a residential structure every 80 seconds.

The solution resides in automatic sprinkler systems that are usually triggered within 4 minutes of ignition when the temperature rises above 120 degrees. The National Fire Protection Association (NFPA) has no record of a fire killing more than two people in a fully operational sprinklered public assembly, educational, institutional or residential building. Furthermore, sprinklers are responsible for dramatically reducing property loss from as low as 42% to as high as 70%, depending on the structure.

Fire sprinklers are the single most effective method for fighting the spread of fires in their early stages—before they can cause severe injury to people and damage to property. There are literally thousands of high-rise buildings built under older codes that lack adequate fire protection. In addition, billions of dollars were spent to make these and other buildings handicapped accessible; however, people with disabilities now occupying these buildings are not adequately protected from fire.

At recent code hearings, representatives of the health care industry testified that there are approximately 4,200 nursing homes that need to be retrofitted with fire sprinklers. They further testified that the billion plus cost of protecting these buildings with fire sprinklers would have to be raised through corresponding increases in Medicare and Medicaid.

In addition to the alarming number of nursing homes lacking fire sprinkler protection there are literally thousands of assisted living facilities housing older Americans and people with disabilities that lack fire sprinkler protection.

In early 2003, the “Station” nightclub fire in Rhode Island killed 100 occupants. Still today there are thousands of similar nightclubs and entertainment venues that need to be retrofitted with fire sprinklers.

Building owners do not argue with fire authorities over the logic of protecting their buildings with fire sprinklers. The issue is cost. Passage of H.R. 1824 would drastically reduce the staggering annual economic toll of fire in America and thereby dramatically improve the quality of life for everyone involved.

Benefits of the Fire Sprinkler Incentive Act also include lower local fire department costs, increased loan activity, reduced insurance claims and premium costs, larger numbers of retrofitting and installation jobs and the generation of payroll tax revenue.

This bill encourages property owners to install fire sprinkler systems by reducing the tax depreciation time on nonresidential real property from 39 years to only 5. The benefits of this bill include lower fire department costs, increased loan activity, reduced insurance claims and premium costs, increased retrofitting and installation jobs, and the generation of payroll tax revenue. Most importantly, this bill saves lives.

The installation of fire sprinklers is a high priority for the fire community and others concerned with the protection of American lives and property. The following organizations have already pledged their support for this Act:

National Fire Protection Association
Society of Fire Protection Engineers
International Association of Fire Chiefs
American Insurance Association
National Volunteer Fire Council
Independent Insurance Agents & Brokers of America
International Association of Fire Fighters
The Associated General Contractors of America
International Association of Arson Investigators
The Lightning Safety Alliance
National Association of State Fire Marshals
American Society of Safety Engineers
International Fire Marshals Association
American Health Care Association
American Fire Sprinkler Association
Underwriters Laboratories, Inc.
National Fire Sprinkler Association
International Code Council

The bill is currently written to apply to all sprinkler installations, which includes new and retrofitted buildings. The following is a cost estimate that Ways and Means Committee did for 'retrofitting only' as well, just in case the original is too costly.

Tax Depreciation Cost to the U.S. Revenue (millions of dollars)

	2004	2005	2006	2007	2008	2004–2013
Current version: tax incentive for ALL sprinkler installations	453	587	666	832	975	9,420
Alternate version: tax incentive for RETROFITS only	113	147	166	208	244	2,355

Year after year, these facts stare us square in the face, costing thousands of lives and billions of dollars, but no efforts are made to install sprinkler systems in older buildings or those in jurisdictions that do not require them due to one reason: cost.

With the support of every fire service and related association in America, Representative James Langevin and I introduced the Fire Sprinkler Incentive Act, H.R. 1824. This bill provides a tax incentive for businesses to install sprinklers through the use of a 5-year depreciation period, opposed to the current 27.5 or 39 year period for installations in residential rental and non-residential real property respectively. While only a start, the bill intends to eliminate the massive losses seen in nursery homes, nightclubs, office buildings, apartment buildings, manufacturing facilities and other for-profit entities.

Chairman MCCRERY. Thank you, Mr. Weldon. Next, another Member from the State of Ohio, Mr. Kucinich. You may proceed.

STATEMENT OF THE HONORABLE DENNIS J. KUCINICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. KUCINICH. Thank you very much, Chairman McCrery, Ranking Member McNulty, for holding this hearing. I would like to bring to your attention and the attention of the Members of the Committee a proposal I introduced last year that I believe would have a positive impact on millions of taxpayers. I think it is fair to say that all Members of Congress believe we need to strive for a fair, simple, and adequate tax system. We may disagree on how that is to be accomplished, but I think we have the same goals. However, I think we can all agree on a need for transparency. Transparency in the tax system is necessary to achieve fairness. Transparency permits the taxpayer to understand how fairness is arrived at in the Tax Code. A simplified Tax Code can provide this transparency, which in turn provides a sense of trust in government. My hope is that this Committee will seriously consider my proposal to create a $2,000 simplified family credit, a refundable tax credit that simplifies the Tax Code by consolidating the earned income tax credit, child tax credit, additional child credit, and exemption for children into one streamlined, simplified family credit. This tax credit will simplify the Tax Code, provide greater transparency, provide extra work incentives, and provide a stimulus effect.

Families should not have to struggle to understand the eligibility requirements for each of the various family tax breaks in current law. All families should follow the same set of rules. The simplified family credit is structured to provide progressive tax benefits and a work incentive. The families with lower income will get more benefit, but they are also rewarded for work. The credit would be steeply phased in at the lowest income levels, providing the incentive to work, and a substantial benefit. As income rises, a slow phaseout would be necessary to ensure we maintain a progressive tax system. The cost of this proposal would fall in the range of $20 billion a year. Given our current deficit problems, I believe Congress should only create the simplified family tax credit if it is paid for. In my legislation, H.R. 3655, there are several options to pay for this proposal, including rolling back parts of the tax cuts enacted in the last 3 years. Those tax cuts only added to the complexity of the Tax Code and removed any remaining transparency. I want to thank this Committee for the opportunity to testify. Thank you.

[The prepared statement of Mr. Kucinich follows:]

Statement of The Honorable Dennis Kucinich, a Representative in Congress from the State of Ohio

Thank you Chairman McCrery and Ranking Member McNulty for holding this important hearing. I would like to bring to your attention a proposal I introduced last year that will have a positive impact on millions of taxpayers.

I think it is fair to say that all Members of Congress believe we need to strive for a fair, simple, and adequate tax system. We may disagree on how this is being accomplished, but we have the same goals.

However, I think we can agree on the need for transparency. Transparency in the tax system is necessary to achieve fairness. Transparency permits the taxpayer to understand how fairness is arrived at in the Tax Code. A simplified Tax Code can provide this transparency, which in turn provides a sense of trust in the government.

My hope is that this Committee will seriously explore my proposal to create a $2,000 Simplified Family Credit, a refundable tax credit that simplifies the Tax Code by consolidating the Earned Income Tax Credit (EITC), Child Tax Credit, Additional Child Credit, and exemption for children into one streamlined Simplified Family Credit. This tax credit will simplify the Tax Code, provide greater transparency, provide extra work incentives, and provide a stimulus effect.

Families should not have to struggle to understand the eligibility requirements for each of the various family tax breaks in current law. All families should follow the same set of rules.

The Simplified Family Credit is structured to provide progressive tax benefits and a work incentive. The families with lower income will get more benefit, but they are also rewarded for work. The credit would be steeply phased in at the lowest income levels providing the incentive to work and a substantial benefit. As income rises a slow phase out would be necessary to ensure we maintain a progressive tax system.

The cost of this proposal would fall in the range of $20 billion a year. Given our current deficit problems, I believe that Congress should only create the Simplified Family Tax Credit if it is paid for. In my legislation H.R. 3655, there are several options to pay for this proposal including rolling back parts of the tax cuts enacted in the last 3 years. Those tax cuts only added to the complexity of the Tax Code and removed any remaining transparency.

Thank you for this opportunity to testify today.

Chairman MCCRERY. Thank you, Mr. Kucinich. Now the gentleman from Colorado, Mr. Beauprez. Mr. Beauprez.

STATEMENT OF THE HONORABLE BOB BEAUPREZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF COLORADO

Mr. BEAUPREZ. Thank you, Mr. Chairman and Ranking Member McNulty and distinguished colleagues on the panel, on the

Committee. Like many of you, I very much look forward to the day when we have a debate over the Tax Code in its entirety. I believe we are rapidly reaching consensus that the Tax Code is far too complex and inadvertently produces disincentives for some of the values that have traditionally made America great. The current Tax Code laws serve as a disincentive to work, thrift, marriage, and charity. This has to change, and I hope to see that change soon. However, this is as much as we can do today to make an immediate positive impact on the lives of millions of seniors and low-income and middle-income families. Mr. Chairman, despite the fact that Social Security was never intended to be the sole source of retirement income for American seniors, for far too many it has become exactly that; and unless you have supplemental retirement income, either through your previous employer or personal savings, Social Security by itself doesn't provide very much. I want to talk about two proposals, both of which are included in one of the first pieces of legislation I introduced, that will bring relief to millions of American retirees and low-income taxpayers.

Mr. Chairman, the first proposal that I would like to discuss is the reduction, or even elimination, of the double taxation of Social Security benefits. Not only is this a healthy thing to do for the economy, it is the right thing to do as well. Nearly everyone knows that the Social Security system provides monthly benefits to qualified retirees, disabled workers and their spouses and dependents. However, what many people do not realize is that after they have paid Social Security taxes throughout their entire life and their working careers, up to 85 percent of the monthly benefit they receive from Social Security may be taxed again. It is interesting to note that until 1984, Social Security benefits were exempt from the Federal income tax. In 1983 Congress passed legislation that made up to 50 percent of the Social Security benefits taxable for taxpayers whose income plus one-half of their Social Security benefits exceeded $25,000 for an individual, or 32,000 for a married couple filing a joint return. Then, in 1993, Congress saw fit to increase this portion of benefits that were eligible for taxation from 50 percent to 85 percent. This tax increase on senior citizens made a bad policy even worse. Essentially, this graduated tax scheme penalized seniors with their fixed incomes who have worked hard to ensure their retirement security.

Another area for concern that is rarely mentioned in this debate, but carried additional negative consequences to America's seniors, is that many States use Federal adjusted gross income subject to taxation as a basis for their own income taxes. Not only have we imposed a tax on these benefits, we have also triggered a State income tax as well in many of our States. Eliminating the tax on Social Security benefits or, at the very least, repealing the 1993 tax increase will positively impact millions of our seniors who find themselves on fixed incomes and facing rising payment for health care, housing, energy and food costs. In addition, it will increase the buying power of a large segment of our economy and help further our recovery. Another way I believe the government can do more to help seniors is to promote responsible savings, which is why I am also here to advocate the elimination of taxes on savings accounts. As a former community banker, I have first-hand knowledge that many low- and middle-income taxpayers have no other investment in their—other than their passbook savings accounts.

Upper-income taxpayers tend to have much more sophisticated investments. Very few of them keep large amounts of money in passbook savings accounts. So, elimination of taxes on savings accounts will benefit lower-income, working families and senior citizens who rely on interest to supplement their Social Security benefits. As I said earlier, I very much look forward to the day when we take up the challenge of overhauling the entire Tax Code. Until that occurs, there are some in our society who desperately need, and undoubtedly deserve, immediate relief. Furthermore, I firmly believe that especially during this time of economic recovery, we need to do more to help those in our communities who need it the most. I am confident that by reducing the tax burden on our Nation's seniors, along with our low- and middle-income taxpayer, we would improve the lives of millions while encouraging our economy to grow. Mr. Chairman, again I want to thank you for allowing me to appear before you today. I will look forward to continuing the work with you and other distinguished colleagues who are here today to pass legislation that will reduce the tax burden for all taxpayers and bring simplicity to our confusing tax laws. I would be happy to answer any questions you might have. Thank you, Mr. Chairman.

[The prepared statement of Mr. Beauprez follows:]

Statement of The Honorable Bob Beauprez, a Representative in Congress from the State of Colorado

Let me first begin by thanking you Mr. Chairman, the Ranking Member, and my other distinguished colleagues who serve on this Committee for allowing me the opportunity to appear before you today.

Like many of you, I very much look forward to the day when we have a debate over the Tax Code in its entirety. I believe we are rapidly reaching a consensus that the Tax Code is far too complex and inadvertently produces disincentives for some of the values that have traditionally made America great. The tax laws we currently have in place serve only as a disincentive to work, thrift, marriage and charity. This has to change and I hope to see it change soon.

While an over-all fundamental reform of the Tax Code is something that I can't wait to begin discussing in the months to come, there is much that we can be doing today to make an immediate positive impact on the lives of millions of low- and middle-income families.

I am proud of the work this Congress has done to lower the tax burden on all Americans but I want to talk to you today about a specific category of Americans who desperately need additional relief—American seniors.

Mr. Chairman, despite the fact that Social Security was never intended to be the sole source of retirement income for American seniors, for far too many it has become exactly that. And unless you have supplemental retirement income, either through your previous employer or personal savings, Social Security by itself doesn't provide very much.

I want to talk about two proposals—both of which are included in one of the first pieces of legislation I introduced—that will bring badly needed relief to millions of American retirees, and lower income taxpayers.

Mr. Chairman, the first proposal that I would like to discuss would allow Congress to correct a terrible injustice currently being imposed on seniors who have worked hard all of their lives and are receiving Social Security benefits, by eliminating the double taxation of Social Security benefits. Not only is this a healthy thing to do for the economy, it is the right thing to do as well.

Nearly everyone knows that the Social Security system provides monthly benefits to qualified retirees, disabled workers, and their spouses and dependants. However, what many people do not realize is that after they have paid Social Security taxes throughout their entire working careers, up to 85 percent of the monthly benefit they receive from Social Security may be taxed again.

It is interesting to note that until 1984, Social Security benefits were exempt from the federal income tax. But in 1983 Congress passed legislation that made up to 50% of Social Security benefits taxable for taxpayers whose income plus one-half of their Social Security benefits exceed $25,000 for an individual or $32,000 for a married couple filing a joint return.

Then in 1993, Congress saw fit to increase this portion of benefits that were eligible for taxation from 50% to 85%. This tax increase on senior citizens made a bad policy even worse. Essentially, this graduated tax scheme penalizes seniors with fixed incomes who have worked hard to ensure their retirement security.

Another area for concern that is rarely mentioned in this debate, but carries additional negative consequences to America's seniors is that many states use federal adjusted gross income—income subject to taxation—as the basis for their own income taxes. So not only have we imposed a federal tax on these benefits, we have also triggered a state income tax as well.

It is clear to me that repealing the current tax on Social Security benefits will positively impact millions of our seniors who find themselves on fixed incomes and face rising payments for healthcare, housing, energy and food cost. In addition, it will increase the buying power of a large segment of our economy and help further our recovery.

It is widely agreed, however, that Social Security was never intended to be the sole source of income for retirees. One way that I believe the government can do more to help make seniors less dependent on Social Security benefits alone is to promote responsible savings, which is why I am also here to advocate the elimination of taxes on savings accounts.

As a former community banker, I have first-hand knowledge that many low- and middle-income taxpayers have no other investment than their passbook savings accounts. Upper income taxpayers tend to have much more sophisticated investments. Very few of them keep large amounts of money in a passbook savings account, so elimination of taxes on savings accounts will benefit lower income working families and senior citizens who rely on interest to supplement their Social Security benefits.

As I said earlier, I very much look forward to the day when we take up the challenge of overhauling the entire Tax Code. But until that occurs, there are some in our society who desperately need—and undoubtedly deserve—immediate relief. Furthermore, I firmly believe that especially during this time of economic recovery, we need to do more to help those in our communities who need it the most. I am confident that by reducing the tax burden on our nation's seniors along with our low- and middle-income taxpayers, we will improve the lives for millions while encouraging our economy to grow.

Mr. Chairman, again I want to thank you for allowing me to appear before you today. I look forward to continuing to work with you and our other distinguished colleagues who are here today, to pass legislation that will reduce the tax burden for all taxpayers and bring simplicity to our confusing tax laws and I would be happy to answer any questions you might have.

Chairman MCCRERY. Thank you, Mr. Beauprez. Last on this panel, the gentleman from Ohio, Mr. Ryan. Mr. Ryan.

STATEMENT OF THE HONORABLE TIM RYAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. RYAN OF OHIO. Thank you, Mr. Chairman, Ranking Member McNulty, and also the gentle lady from Ohio. Thank you for allowing me to testify on my bill, H.R. 4243, which provides a tax credit equal to the yearly cost of qualified college textbooks. I am also proud to say that it has been endorsed by both the National Association of College Stores and the American Association of Publishers. Mr. Chairman, I would like to submit the American Association of Publishers letter for the record.

Chairman MCCRERY. Without objection.

[The information was not received at the time of printing.]

Mr. RYAN OF OHIO. It is not a secret that our students are paying more for their education, more are graduating with student loans, and the student loans are larger. The cost of college for our country's students is out of control. Last week, the biennial study for the National Center for Public Policy and Higher Education drops the country to an "F" rating in affordability from the "D" it received in the nonprofit group's report 2 years ago. It is not our students who are failing us, it is our States and Federal Government receiving the flunking grade by not acting decisively to make college more affordable. On affordability, the report directly contradicts studies that state increases of financial aid have kept pace with tuition hikes and college costs have stabilized. The result, college is becoming less affordable. How can we help our students and their families? My legislation will give financial relief in an area that is a significant part of a student's education, the cost of textbooks. Our students are spending an ever-increasing amount on textbooks. According to the National Association of College Stores, the wholesale price of college texts has gone up 32.8 percent since 1998, while the price of ordinary books rose just 18 percent over the same period. That is an average annual increase of 5.9 percent for college texts and 3.1 percent for regular books.

Increasingly, students are paying upward of $1,000 per school year for textbooks, and my legislation allows for an annual tax credit of up to $1,000. One thousand dollars is obviously a lot of money for a student. To put it in perspective, in the 2002–2003 school year, the average Pell grant recipient was only awarded $2,436. One thousand dollars spent on textbooks is 41 percent of that average Pell grant award. House Resolution 4243 is not just limited to students, because many families work together to afford the cost of a family member's college education. Most full-time students might not receive all of the benefits of this tax credit, because their time is spent in the classroom and not working. So, this tax credit can be used by those parents who help pay for their son's or daughter's textbooks. My legislation gives a tax credit to the taxpayer, the taxpayer spouse or any dependent of the taxpayer with respect to whom the taxpayer is allowed the deduction under Section 151 and who is an eligible student.

To put this in perspective, consider the following example: a family of four with an annual income of $40,000, sending one of their children to college, spent—will spend $1,000 on textbooks for the year. They would have incurred Federal taxes of $2,041, but with my legislation, will receive the full tax credit and only incur a Federal tax liability of $1,041. Mr. Chairman, my bill is not going to solve the college affordability issue completely, but it is a step in the right direction by recognizing that students and their families need more financial help. We need to support the pursuit of higher education, and I thank you for your consideration. We have almost 250,000 college-eligible people in this country who want to go to college, but feel, one way or another, they can't afford it; and this legislation helps move us in the direction to incentivize that for them. So, I thank the Committee for the opportunity.

[The prepared statement of Mr. Ryan follows:]

Statement of The Honorable Tim Ryan, a Representative in Congress from the State of Ohio

SUMMARY OF BILL:

H.R. 4243 amends the Internal Revenue Code to allow a nonrefundable tax credit for the cost of college textbooks. Limits the amount of such credit to $1,000 for any taxable year.

TESTIMONY

Mr. Chairman and Ranking Member:

Thank you for allowing me to testify on my bill, H.R. 4243, which provides a tax credit equal to the yearly cost of qualified college textbooks. I am also proud to say that it has been endorsed by both the National Association of College Stores and the American Association of Publishers. Mr. Chairman, I would like to submit the American Association of Publishers' letter for the record.

COST OF COLLEGE OUT OF CONTROL

It is not a secret that our students are paying more for their education, more are graduating with student loans, and the loans are larger. The rising cost of college for our country's students is out of control. Last week, the biennial study by the National Center for Public Policy and Higher Education drops the country to an "F" in affordability from the "D" it received in the nonprofit group's report two years ago. It is not our students who are failing us; it is our state and federal governments receiving the flunking grade by not acting decisively to make college more affordable.

On affordability, the report directly contradicts studies that state increases in financial aid have kept pace with tuition hikes and college costs have stabilized. The result? College is becoming less affordable.

How can we help our students and their families? My legislation will give financial relief in an area that is a significant part of a student's education—the cost of textbooks.

STUDENTS SPEND LARGE AMOUNT ON TEXTBOOKS

Our students are spending an ever increasing amount on their textbooks. According to the National Association of College Stores, the wholesale price of college texts has gone up 32.8% since 1998, while the price of ordinary books rose just 18% over the same period—that's an average annual increase of 5.9% for college texts and 3.1% for regular books. Increasingly, students are paying upwards of $1,000 per school year for textbooks, and my legislation allows for an annual tax credit up to $1,000. $1,000 is a lot of money for a student. To put it in perspective, in the 2002–2003 school year, the average Pell Grant recipient was only awarded $2,436. $1,000 spent on textbooks is 41% of that average Pell Grant award.

Parents

H.R. 4243 is not limited to just the students, because many families work together to afford the cost of a family member's college education. Most full-time students might not receive all of the benefits of this tax credit because their time is spent in the classroom and not working, so this tax credit can be used by those parents who help pay for their son or daughter's textbooks. My legislation gives the tax credit to the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer with respect to whom the taxpayer is allowed a deduction under section 151 and who is an eligible student.

SAVINGS PER FAMILY

To put this in perspective, consider the following example.

- A family of four with an annual income of $40,000.
- Sending one of their children to college.
- Has spent $1,000 on textbooks for the year.
- If taking the standard deduction, would have incurred federal taxes of $2,041, but with my legislation, will receive the full tax credit and only incur a federal tax liability of $1,041.

SCORE

My bill has not yet been scored.

THANK YOU

My bill is not going to solve the college affordability issue completely, but it is a step in the right direction in recognizing that students and their families need more financial help. We need to support the pursuit of higher education and I thank you for your consideration of this request.

Chairman MCCRERY. Thank you, Mr. Ryan. Again, I think the members of the panel did an excellent job of laying out your proposal. As a consequence of that, I don't have any questions. I would point out to Mr. Neugebauer that he did such a good job, that there is going to be a bill on the floor this afternoon which contains an extension of the wind energy tax credit. So, congratulations. Mr. Weldon, you did almost as good a job. There is going to be a bill on the floor, we hope next week or the week after.

Mr. WELDON. Really?

Chairman MCCRERY. Well, don't get too excited. It does contain a reduction in the depreciation period from 39 years to 15 years for leasehold improvements for restaurants, so this is one of the things that they could take advantage of by putting in sprinklers and getting a shorter depreciation period. So, it is a start. With that, I will turn it over to Mr. McNulty.

Mr. MCNULTY. Thank you, Mr. Chairman. I would echo your remarks, I think each of the Members did an excellent job. I am already a cosponsor of Mr. Weldon's legislation. I find a number of the other proposals very appealing. They certainly deserve the consideration of this Subcommittee, the Committee, and the full House. With that, I will yield to Ms. Tubbs Jones.

Mrs. JONES. Mr. Chairman, Mr. Ranking Member, thank you very much. I also am a cosponsor of Mr. Weldon's legislation. I also have in the hopper somewhere a piece of legislation providing benefits to the college and university dormitories, fraternities and sororities, for fire prevention, because it becomes such a serious issue for our young men and women who live in facilities where they are not provided with the appropriate fire prevention tools to keep them from being victims of fire. So, I congratulate Mr. Weldon and support him. I didn't realize—I wasn't a cosigner on Mr. Ryan's legislation. I have a college student. I probably don't qualify for the credit, but it would be great for my constituents to also have the ability to get some type of credit for books. It seems like my son is calling me all the time, Mom, this book is $150; Mom, this book is $250. I said, go print your own. No, I didn't. Just, can I go—an aside. It is a serious cost and struggle for families who are trying to pay college tuition and the like. To all of my colleagues, thank you for coming forward with these suggestions, and we will continue to be supportive and give you the opportunity to do this. I am assuming, Mr. Chairman—well, I won't say "we." The Chairman will continue to do that. Thank you very much. I yield back.

Chairman MCCRERY. Thank you, Ms. Tubbs Jones. Mr. Ryan.

Mr. RYAN OF WISCONSIN. I will be brief. No questions. Mr. Weldon, I think I am a cosponsor on your bill as well. I think we are getting a good consensus on that measure. Mr. Beauprez, I think you are hitting the nail on the head. The Social Security tax is a double tax. People already paid taxes on that dollar. It is really a back-door benefit cut, so I think your presence here and your testimony on that are right on target. Thank you all for coming.

Chairman MCCRERY. Thank you. Thank you all again, gentlemen, for your excellent testimony. Now, will the third panel please come forward. Thank you. Ms. Blackburn coming a little early. The third panel was not supposed to be queued up until 2:00 p.m., but thanks to the concise testimony of the other two panels, we are a little ahead of time. As Mr. McNulty pointed out, we are probably the only Committee in Congress that is ahead of schedule. So, we are pleased that you are here early, and we are going to allow you to proceed. Your written testimony will be included in the record, but we would like for you to sum up your testimony in about 5 minutes, if you would, and then we will see if any other Members have shown up to testify. If not, we will ask you questions at that time. You may proceed.

STATEMENT OF THE HONORABLE MARSHA BLACKBURN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TENNESSEE

Ms. BLACKBURN. Thank you, Mr. Chairman. I will have to tell you that I do believe our Government Reform Committee hearing on piracy and counterfeit goods of intellectual property items was running a little ahead of schedule also today. That is why I am able to jump out of that one, even though it is proceeding, to be here with you. I do want to thank you and the Members of your Committee for holding the hearing today and giving us an opportunity to talk about some of the tax issues that are very important to us; and I want to offer my support. The reason I am here today is to offer my support for H.R. 3776, the Songwriters Capital Gains Tax Equity Act, which was introduced by my friend from Kentucky and a Member of your panel, Congressman Ron Lewis. We appreciate his leadership on that issue. From 1995 until late 1997, I was Executive Director of Tennessee's Film Entertainment and Music Commission, and through that experience, I came to know and to fully appreciate the challenges that are facing our entertainment industry and the individuals who are working in that industry. So, when I was elected to Congress, I knew that there were certain Federal problems that I wanted to put some energy into and try to help seek a remedy to.

Mr. Lewis's bill is a recent solution to a significant problem. Right now, our songwriters are forced to pay income tax when they are selling their life's work. Their catalog sale ends up factoring into their income, rather than being treated as a capital gain. We don't do this with the sale proceeds generated by works of literature that are produced by authors, but we do it with songs and with our songwriters. The reality is that few people know the songwriters and even fewer know of the challenges our Tax Code presents to them. The songwriters are the hidden component in our entertainment industry. Everybody probably knows, and I would be willing to venture a guess, Mr. Chairman, that you are familiar with the song "Heartbreak Hotel," that it was the song that launched Elvis Presley's career. It was his first single for RCA Records and it topped the Billboard charts around the world; it was the best selling single of 1956. However, this song was not written by Elvis Presley. This song was written by a wonderfully sweet lady and very dear friend from Hendersonville, Tennessee, the late

Mae Axton. She and her songwriting partner, Tommy Durden, were reading the newspaper in 1955, and they came across what they thought was a heartbreaking story about a man who killed himself and left a note with the line, "I walk a lonely street." They were inspired—sitting down together, they were inspired to flip over that sheet of paper and write out the lyrics. Then they produced a demo. Writing that song took them about 22 minutes.

That is the community that we are talking about, the people behind the headline. These are the people we are trying to help. I have worked with this wonderfully creative and entrepreneurial community, and I can tell you, they are the epitome of self-employed small business people. Unlike the average small business owner, and what makes this issue so unique, is that the songwriters have their rate of pay set by Federal statute. It is 17 U.S.C. 801. The Federal Government sets that rate of pay, and if a songwriter does well and has many songs recorded, that collection of lyrics and music is known as a catalog. When a songwriter decides to sell this catalog, this compilation of their life's work, meaning that they are no longer going to get royalties off of that airplay—they have passed it on, sold it—this asset is taxed as income instead of as a capital gain. That is the crux of the problem.

That is the situation, and Mr. Lewis's Songwriters Capital Gains Tax Equity Act would give songwriters the parity they deserve and treat their sales as capital gains rather than income. In my district, which stretches from Memphis—which we know is the home of blues, and it is the birthplace of Rock and Roll—to Nashville, which is Music City USA, songwriters are our neighbors, they are our friends. They are the people that we work with every single day. We know how very important this issue is to them. When I came to Congress, one of the first things that I did was to create the Congressional Songwriters Caucus here in the House to highlight this issue for our Members, and at every Guitar Pull that we have had on the Hill, this topic comes up. It is a front-burner issue for our songwriters, and I am hopeful that this Committee can see merit in Representative Lewis's approach. Thank you, Mr. Chairman.

Chairman MCCRERY. Thank you, Ms. Blackburn. Before I call on Mr. Sessions—Mr. Sessions, you can come on up and take your seat—I just want to point out that I did nod affirmatively, when you asked if I was familiar with "Heartbreak Hotel," that is only because I have two much older sisters who were Elvis Presley fans.

Ms. BLACKBURN. I will accept that answer, sir.

Chairman MCCRERY. Thank you. We will reserve our questions, Ms. Blackburn, if you can stay until the completion of Mr. Session's testimony. Now I would like to introduce the gentleman from Texas, Mr. Sessions. Mr. Sessions, your written testimony will be included in the record. You will have about 5 minutes to summarize your remarks, and you may proceed.

STATEMENT OF THE HONORABLE PETE SESSIONS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. SESSIONS. Thank you, Mr. Chairman. I want to thank you and the Members of the Subcommittee today for allowing me to turn on my mike. There it is.

Ms. BLACKBURN. Way to go.

Mr. SESSIONS. In the Rules Committee we have people there to turn them on. I guess we don't here. Mr. Chairman, I want to thank you for giving me the opportunity to speak today, and I would like to let you know that much of the material that I am going to provide you today was given to me by the National Center for Policy Analysis that has done a lot of work on the information that I am going to provide. Today, Mr. Chairman, I would like to discuss the adverse effects of the Tax Code on women. Now, of course, the Tax Code doesn't tax men at one rate and women at another. Theoretically it treats them equally. Due to different work patterns between men and women, the outcome of our tax law is often negative for women. One major reason for this is that the career path of a woman is usually different from that of a man. According to the Census Bureau, 38.6 percent of the women between the ages of 20 and 64 choose not to work outside the home in order to take care of their children, compared with only 2.6 percent of men. As a result, women tend to move in and out of the workforce. They are also more likely to have part-time employment or to seek flexible hours or what we might call family friendly workplace. As a result of these patterns, women are frequently penalized by the Tax Code. In particular, they are much less likely to be eligible for employee benefits. Married women face higher marginal tax rates than their single counterparts. Other factors, such as longer life expectancies, also have an impact.

A prime example of the Tax Code's inequitable impact on women is retirement savings. Because of their work patterns, women are less likely to qualify for benefits such as a 401(k) plan, and a woman who does qualify may not be able to invest if she pauses her career to take care of children. One study found that among employees ages 18 to 62, the average balance in 401(k)s and similar accounts for women was about half of that of men. Unfortunately, there is no 401(k) equivalent for moms who stay at home. Traditional IRAs or spousal IRAs are options, but the contribution level limits are lower. The opportunity to accumulate tax-favored savings shouldn't depend on where or if a person is employed. We need to be especially concerned about the women's retirement savings, because they have a longer life expectancy and are more likely to live alone. Women need a larger nest egg to cover their expenses throughout retirement, and those who do save will still face a host of taxes on retirement income and Social Security benefits.

Another area of concern is health care. Employers are able to deduct their expenses for providing health insurance, but individuals do not receive the same deduction if they purchase coverage on their own. Because of such outdated laws, health insurance availability is tied to full employment, but many women in nontraditional work roles do not qualify for employer-provided health care. One measure that addresses health care coverage is H.R. 583, the Fair Care for the Uninsured Act, which would create a refundable tax credit of $1,000 per adult or $3,000 for each family for the purchase of private health insurance. This credit would be available to individuals who do not have access to employer-based health insurance or who are not enrolled in a government health program. These are just a few of the challenges that women face in retirement planning, health care and many other areas, and I know this because I have a wife and a mother who are very concerned about not only their future but the future of many women who are their friends.

Fortunately, Republicans and President Bush have enacted numerous measures that alleviate these problems with the Tax Code. We have passed the marriage penalty tax relief and higher IRA limits. These measures are in danger of expiring and do not fully address the inequities of the law. The newly created health savings accounts were also created to help improve health care coverage. There is much more that I think we need to do and certainly I am trying to challenge our Committee to do today in our future. On a broad scale, comprehensive tax reform such as a flat tax would eliminate many of the Tax Code inequities. In the meantime, though, we should examine more specific proposals such as Fair Care. Many of our tax laws are still based on the old assumption that a family will have a single earner, employed full time by one company that provides full benefits, but now this model is the exception rather than the rule. Of course, the problems I have discussed apply to many men as well. However, women are affected far many times more. With the roles of men and women continually evolving, we need to replace our outdated tax laws with forward-looking reform, with the new ideas of the millennium, and maximize the opportunity of each of our citizens. I thank the gentleman for allowing me to be here today, and I will make myself available for questions, as necessary, by this Committee.

[The prepared statement of Mr. Sessions follows:]

Statement of The Honorable Pete Sessions, a Representative in Congress from the State of Texas

Mr. Chairman, I want to thank you for giving me and my colleagues the opportunity to contribute to this important discussion.

Today, I'd like to discuss the adverse effects of the Tax Code on women. Now, of course, the Tax Code doesn't tax men at one rate and women at another. Theoretically, it treats them equally. But due to the different work patterns between men and women, the *outcome* of our tax laws is often more negative for women.

One major reason for this is that the career path of a woman is usually different from that of a man. According to the Census Bureau, 38.6 percent of women between the ages of 20 and 64 choose not to work outside the home in order to take care of children, compared with only 2.6 percent of men.[1] As a result, women tend to move in and out of the workforce. They are also more likely to have part-time employment or to seek flexible hours or a "family-friendly" workplace.

As a result of these patterns, women are frequently penalized by the Tax Code. In particular, they are much less likely to be eligible for employee benefits. Married women may face higher marginal tax rates than their single counterparts. Other factors, such as longer life expectancy, also have an impact.

A prime example of the Tax Code's inequitable impact on women is retirement savings. Because of their work patterns, women are less likely to qualify for benefits such as 401(k) plans. And a woman who does qualify may not be able to vest if she pauses her career to care for her children. One study found that among employees ages 18 to 62, the average balance in 401(k)s and similar accounts for women was half that of men.[2]

Unfortunately, there is no 401(k) equivalent for moms who stay at home. Traditional IRAs or Spousal IRAs are options, but the contribution limits are much

[1] U.S. Census Bureau, "Reasons People Do Not Work, 1996," Table 3, p. 5, http://www.census.gov/prod/2001pubs/p70-76.pdf.

[2] Vickie Bajtelsmit, Alexandra Bernasek, and Nancy Jianakoplos, "Gender Differences in Defined Contribution Pension Decisions," *Financial Services Review*, Vol. 8 (1999), p. 5.

lower.[3] The opportunity to accumulate tax-favored savings shouldn't depend on where or if a person is employed.

We need to be especially concerned about women's retirement savings because they have a longer life expectancy and are more likely to live alone. Women will need a larger nest egg to cover their expenses throughout retirement. Those who do save will still face a host of taxes on retirement income and Social Security benefits.

Another area of concern is health care. Employers are able to deduct their expenses for providing health insurance, but individuals do not receive the same deduction if they purchase coverage on their own. Because of such outdated tax laws, health insurance availability is tied to full-time employment. But many women in non-traditional work roles do not qualify for employer-provided health insurance. One measure that addresses health care coverage is the Fair Care for the Uninsured Act (H.R. 583), which would create a refundable tax credit of $1,000 per adult or $3,000 per family for the purchase of private health insurance. This credit would be available to individuals who do not have access to employer-provided health insurance or who are not enrolled in a government health insurance program.

These are just a few of the challenges that women face in retirement planning, health care, and many other areas. Fortunately, Republicans and President Bush have enacted numerous measures that alleviate some of the inequities in the Tax Code. We have passed marriage penalty relief and higher IRA limits, but these measures are in danger of expiring and do not fully address the inequalities in our tax law. The newly created Health Savings Accounts will also help to improve health care coverage, but there is much more we can do.

On a broad scale, comprehensive tax reform, such as a flat tax, would address many of the Tax Code's inequalities. In the meantime, though, we should examine more specific proposals such as Fair Care.

Many of our tax laws are still based on the old assumption that a family will have a single earner, employed full time by one company that provides full benefits. But now this model is the exception, rather than the rule. And of course, the problems I've discussed apply to many men as well. However, women are affected much more often. With the roles of men and women continually evolving, we need to replace our outdated tax laws with forward-looking reforms that reflect the realities of the new millennium and maximize the opportunities for all citizens.

Chairman MCCRERY. Thank you, Mr. Sessions. Ms. Blackburn, you talked about the catalog of songs that a songwriter might at some point sell. What if it is just a single song that he gets royalties on for, say, 5 years, and then he just wants to sell that song? Would he still qualify for the tax break in your bill?

Ms. BLACKBURN. Chairman McCrery, one of the things that happens in the industry is, when a songwriter writes that song, then they will get their royalty on that as long as they own that song. It is the same thing as if you owned a piece of property that was a rental piece of property. Then, as long as you own that property and rent it out, that rent check comes to you. The day you sign the deed and you sell it and you turn it over, you no longer have anything to do with it. It is the—it is the same thing that happens when you have a song. Now, what songwriters will do—and Mr. Lewis may also want to speak to this just a little bit—what they will do is, generally they retain the ownership of their songs until they are ready to retire and then, at that point, they will sell their life's work. Now, as with many small business people, who have built a factory, whether it is a tool and die factory or a clothing manufacturing factory, they are—or insurance agent who has a book of business. They are gathering and building, and they are making residual income and they are working through that process for many, many years. They decide to retire. They know this busi-

[3] $3,000 for IRAs vs. $13,000 for 401k in 2004.

ness that they have built or the property that they have owned has been their work, and they decide to sell that. That is—that lifetime of work, all of those songs, that is an artist's catalog, and once they make that sale, it is gone.

Chairman MCCRERY. Maybe Mr. Lewis can expound on that. What if a songwriter doesn't wait until he wants to retire, but is there a holding period in their bill—a year or 5 years or whatever—at which point he can get capital gains treatment?

Mr. LEWIS. Well, I think what Ms. Blackburn is saying is, it is—and the one-song scenario, I am not sure that a person would be interested in selling one song. An example is, like Hal David, the writer of many, many songs, "Raindrops Keep Falling on My Head," and of Rudy Vallie and others, a whole career of writing songs that he put into his catalog. Upon wanting to—reaching a period in his life that he would want to retire, if he sold that catalog or, as Marsha just said, if I was a small business owner, and I put my whole life investment into that business, mortgaged my home and everything, basically all the profit I made I put back into that business building that, because I knew one day that I would probably retire on the basis of selling that business, well, that would be fine for me because I would have paid capital gains instead of income tax on that. The songwriters are saying the same thing. They are building, they are building for that future. So, they are compiling those songs, and one day they hope to sell that small business that they have acquired over the years and the investment that they have put into it, and they don't want to have to pay income tax. They want to be like any other small business and pay capital gains tax. So, we are concentrating on that individual that has built a business over the years so that they can retire.

Chairman MCCRERY. Okay. Thank you. Mr. Sessions, you certainly point out an area that this Committee has concerned itself with over the last few years, and that is trying to make sure that women in the workplace are given favorable treatment to counter the disadvantage that they have because of the facts of life, as you outlined, that they have interruptions in their work life. When they have kids, they leave the workplace. They come back. It is an area that we have made some improvements in, but I agree with you that we need to continue to look at that and continue to make sure that the Tax Code does a good job of taking into consideration those lifestyle differences for women. So, we will certainly continue to do that, and I appreciate your comments today on that subject.

Mr. SESSIONS. Thank you, Mr. Chairman.

Mr. MCNULTY. I have no questions. I want to thank both of my colleagues for their presentations.

Chairman MCCRERY. Thank you. Mr. Lewis, do you have any questions?

Mr. LEWIS. No.

Chairman MCCRERY. Mr. Ryan. I thank both of you very much for your excellent testimony. We appreciate your taking time to come by our Committee and share with us your thoughts. As we develop policy in the next couple of years, I am sure we will consider what you have brought us today and make some improvements in the Tax Code. So, thank you once again. We still have a couple of Members on the third panel that were supposed to be here at 1:00 p.m. So, we will simply wait for a few more minutes. We will leave the record open for a few minutes and see if they get here.

[Recess.]

Chairman MCCRERY. Welcome, Ms. Lofgren.

Ms. LOFGREN. Thank you. I was waiting for this on the floor. I thought this was going to be at 1:00 p.m.

Chairman MCCRERY. Yes, ma'am. We would have waited patiently if we had had to. We have had two panels and we are about halfway through the third panel to testify. Your written remarks will be included in their entirety in the record, but we would ask you to turn on your microphone and summarize your written testimony in about 5 minutes, if you would.

STATEMENT OF THE HONORABLE ZOE LOFGREN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. LOFGREN. Thank you, Mr. Chairman. I will not, I believe, take the entire 5 minutes. When I learned of the great offer to receive testimony from Members who are not Members of the Committee, I wanted to take advantage of that opportunity because of an issue that I tried to bring to the attention of the Committee and, really, in justice to the losers for a period of several years. That has to do with the application of the alternative minimum tax to incentive stock options. I first learned about this when I received a letter from a young man in my district, an engineer, who was facing absolute financial ruin. This kid had roommates. He shared a house with another bunch of recently out-of-college engineers. He was driving a car several years old. He had received incentive stock options and had not known that even though he never received any money from those options, he never made a profit, he never sold them, that he was still subject to a tax on the phantom profit that existed that he was completely unaware of. As time went on, I got other letters from individuals in my district and all across the United States of people who had a tax liability for income they never received.

I introduced a bill last Congress, and before that I was not the only Member to try to bring a remedy to this problem. Congressman Neal and I worked together, and Congressman Johnson has a bill in this Congress. None of these bills has received action. A lot of the individuals who had tax liabilities of hundreds of thousands of dollars on income of maybe $40,000, have gone bankrupt. They have lost their homes. They have lost their cars. The injustice remains. Should the Committee be willing to take action to remedy this, I would be prepared to reintroduce H.R. 1487 in an instant, because it is one of the nastiest and most unfair things I have seen for people to be caught in this terrible situation. People have committed suicide in my district over this problem. All along, we have done a lot to solve tax problems, for large entities. I would urge that we not forget the little guy, the little engineer who got caught in this very strange application of the alternative minimum tax. I think they deserve our attention, and they deserve tax fairness. They deserve justice. So, I wanted to bring that to the attention of the Committee. Should you have any interest or willingness to pursue this, please do let me know, and I will reintroduce my bill. I didn't this year, because I was so discouraged and really had been led to believe by Members of the Committee that no action would be forthcoming. I hope that is not correct. I thank the Committee for your courteous attention to me, and for leaving the record open.

[The prepared statement of Ms. Lofgren follows:]

Statement of The Honorable Zoe Lofgren, a Representative in Congress from the State of California

Mr. Chairman and Ranking Member McNulty, thank you very much for holding this important hearing to allow non-Ways and Means Committee Members of the House the opportunity to testify on tax issues of importance to our constituents. I am here today to discuss the treatment of incentive stock options by the alternative minimum tax.

Four years ago, I received a letter from a very young engineer who was new to the workforce and employment in the Silicon Valley, my district. He was facing financial ruin. Sharing a rented home with two roommates, driving a car several years old, he faced the prospect of sending almost his entire paycheck to the IRS for the foreseeable future.

His letter was only the first. Over the rest of that year, I was inundated with similar letters—administrative assistants, systems analysts, programmers, sales and marketing specialists, human resources managers—all were facing financial crisis. How could that be?

I quickly learned that according to our Tax Code, an employee who exercises stock options and does not sell during that calendar year has a tax liability that is equivalent to the difference between the exercise price and the fair market value at the time of exercise. This is true even if the employee received no money or profit from the sale at all.

Many young engineers, administrative assistants, and other middle income employees have paid thousands of dollars of taxes on "phantom gains" to the IRS. Even if they attempt to use the capital loss credit of $3,000, many of these individuals will be unable to recoup the amount of money they paid to the IRS in their lifetime. Take for example a woman who was able to obtain a second mortgage against her home to pay the $91,000 AMT bill. It will take her over 30 years to get the $91,000 back.

The worst stories are of families who are slapped with thousands of dollars of tax bills while going through family illness or death. One woman's mother passed away in March 2001. Once her mother's probate closed, she not only spent her inheritance, she also spent her sister's inheritance, to pay off her AMT tax liability. She is currently in the process of selling her house that she planned to retire in to pay off the remaining amount she owes the IRS—$140,000.

Another woman tells me that she received an AMT bill three times her family income just after her husband was diagnosed with cancer and was not working regularly. He later passed away and the IRS continued to charge her interest on delayed payments while she struggled to make the payments.

In the 107th Congress, my colleagues and I worked hard to correct this AMT problem. I introduced H.R. 1487, a bill to amend the Tax Code to repeal the alternative minimum tax treatment of incentive stock options, thereby changing the taxable event from the exercise of the stock option to the sale of stock. My bill had 61 bipartisan cosponsors. There were also several other valuable approaches to fixing this problem, one by Representative Richard Neal and another by Representative Sam Johnson. Despite our vigorous efforts towards reform, the Ways and Means Committee never gave us the opportunity for a hearing or markup of our bills.

I am hopeful that with today's hearing, we will finally begin to correct a problem that has already put so many families in financial ruin. If this Subcommittee is serious about helping families, then I will be happy to reintroduce my bill from the 107th Congress *today* so we can have a timely hearing and a markup before we adjourn this Congress.

Four years have passed since this problem exploded. It is time for us to act.

Chairman MCCRERY. Thank you, Ms. Lofgren. We are going to recognize Mr. Emanuel, and then we will ask questions, if you can stay for that. Next on the panel is the gentleman from Illinois, Mr. Emanuel. Please, your written testimony will be included in the record. If you turn on your mike and summarize that in about 5 minutes, we would appreciate it. You may proceed.

STATEMENT OF THE HONORABLE RAHM EMANUEL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ILLINOIS

Mr. EMANUEL. Well, Mr. Chairman, thank you, and I will try to do it in less time so we can get—I know that you have some questions and someone on the panel—as Henry Kissinger used to say, does anyone have any questions for my answers? Obviously, he was serious. I am joking. There are two or three things I would like to address, if possible, and take them up in kind of magnitude from small to larger. One is an issue known in the public as "janitor's insurance," and it has been written on extensively in the Wall Street Journal. It has done about four or five articles on it. It is a policy where corporations buy a life insurance policy on—not key, on what is referred to as "alternative key man insurance," but those lower on the corporate ladder. Many times individuals don't, and their spouses don't know the insurance policies are there. Corporations can do that. As you know, in some of these articles, Wal-Mart buying—one of the most valuable contributors to their bottom line was the janitor's insurance in certain years from a capital perspective and a profit perspective. There are two pieces of the Tax Code where we as a society and as a economy, the rest of us, are subsidizing corporations both on the front end when they buy it and on the buildup of the value of that premium. They get a tax—they basically write it off on their taxes. We as taxpayers have to, in other words, pick it up for them.

What you have here is a company that is buying life insurance on their employees who don't get—many times they or their spouses are not the beneficiary of that policy. In the past, Chairman Archer of this Committee has criticized this. Secretary of the Treasury Don Regan has criticized it. Leaders in the insurance industry themselves have spoken out against it, calling it egregious, and yet this inequity exists in the Code. Now, you can deal with janitor's insurance and try to make it like—or life insurance as a whole, and try to make it like some other insurance policies, and that may be one solution. At this point, to the tune of $10 billion to $12 billion based on estimates, the taxpayers are subsidizing a policy and corporate bottom line when the so-called beneficiaries are not receiving the policy, and I am not sure this is exactly what was intended for the Tax Code. There has been in the past big, bipartisan criticism of this policy. Second, what again was intended for the right reasons, and I think now has been used in a way and has morphed into a process, is the "corporate jet" tax write-off. In many cases, the most egregious example here is the Chief Executive Officer or corporate executive, because the Chief Executive Officer is not the only individual using it, are charged $300—these are examples that have been used in the public domain for their tax purposes and a sense of income—and yet the corporation writes off the use of the corporate jet at that point to the tune of $30,000.

I think we could all agree, it is either $300 or $30,000, but the use of that corporate jet is not both simultaneously. We as taxpayers pick up the $30,000 hit, again costing somewhere—low estimates at about $1.2 billion over 2 years, $2.5 billion—$1.2 billion over 5 years, $2.5 billion over 10 years. I think again an egregious example of where the Tax Code not only does not reflect, I think, our values, but more importantly, economic sense. Again, you can correct an inequity that exists in the Code that also, I think, undermines people's confidence in the tax policy and that the taxes are distributed fairly. Lastly, an idea I have proposed in the past, and I have done other things in my Financial Services Committee on auditors and the sense of tax advice that they have been giving both to companies that they audit, as well as where they are giving tax advice to the Chief Executive Officers of companies they audit. On a separate matter, I introduced a piece of legislation called the Simplified Family Credit. It takes the Earned Income Tax Credit, the Dependent Child Credit, and the Child Credit and collapses approximately 2,000 pages of the Code down to 12 questions. Now, in those three separate credits, there are north of five examples of children, or definitions of children. I know, Mr. Chairman, as a father of a few children, as the father of three children, I think there is only one definition of what a child is and I think we should be able to consolidate that definition.

There is no consolidation and simplification to be brought on the Code. If you did that—I don't agree with some of the others who criticize the earned income tax credit for fraud and abuse, but many times—I will agree that there is fraud, but the fraud is unintended. It is not intentional, as it is in other places, because of the complexity. The way to deal with the abuse in the system would be to bring simplicity so that people know what they are filling out. There is literally a form for 12 questions, reduces 2,000 pages in total by the IRS. It would cost some money, but I also think it would be tremendously good for the economy, and it would bring simplification to the Code. That is a bigger reform idea than the first two. I again want to close by—I appreciate your letting me testify and for also holding this hearing today.

[The prepared statement of Mr. Emanuel follows:]

Statement of The Honorable Rahm Emanuel, a Representative in Congress from the State of Illinois

Chairman McCrery, Ranking Member McNulty, and distinguished members of this Subcommittee, thank you for inviting me to discuss ideas for tax simplification. I commend this Subcommittee for its excellent work and the effort to work to identify ways to relieve Americans from the burden imposed on them by the Tax Code.

I support your goal in this hearing to simplify the Tax Code, which values special interests over middle class families. As you are well aware, the Code is weighed down by more than 300 changes and over 10,000 new pages due to recent tax laws that add more phase-ins, phase-outs, loopholes and sunsets.

This complexity results in inequities and headaches for middle class families, who are all too familiar with convoluted IRS forms and the AMT web. If it takes a typical family seven and a half hours longer to fill out their tax return than it did a decade ago, then we need to simplify the Code. If families must choose between five different kinds of tax definitions their child fits into, then we need to reform those definitions. If a family sending its kids to college must answer 32 pages of questions to apply for a loan, then why do companies applying for Export-Import Bank loans only have to answer one-page of questions?

I have introduced two bills referred to this Committee that close some of the loopholes that favor special interests and corporate America over middle class families: My first bill, H.R. 2127, stops companies from accumulating tax gains from a kind of corporate owned life insurance policy known as "janitors insurance." These policies are sold to employees whose beneficiaries sometimes never realize the benefit. Instead, their employers become the beneficiaries—because they don't pay taxes on the policy's "inside buildup" that accrues as the value of the policy increases. Then, once the insured dies, the company receives the tax-free death benefit. In addition to closing an abusive loophole that has left some survivors with nothing, my bill has bipartisan support and would save taxpayers $10 billion over five years.

My second bill, H.R. 4352, also has bipartisan support. It closes the $3 billion "corporate jet" loophole. Executives who fly in corporate jets for personal travel can write-off this perk for about half the price of a round-trip first-class ticket from New York to L.A. At the same time, the executive's company is permitted to take a full tax deduction for the costs of owning and operating the plane. This can add up into tens of thousands of dollars. This Committee should ask . . . "Is the flight worth the $300 in income the executive reports, or the $30,000 tab that middle-class taxpayers have to pick up?"

Another idea I have proposed is the Simplified Family Credit, to combine four family tax cuts into a single fully refundable credit for working families with children. It reduces thousands of pages of the Code to a simple postcard-sized form. Both sides of the aisle have reasons to work in a bipartisan way toward making this a pillar of reforming the Tax Code: simplification and progressivity.

Finally, I encourage you to consider a "split refund" proposal, allowing taxpayers to split their refunds and direct portions of their refund into different accounts. This idea would increase saving because it makes the process of saving refunds much simpler. Many families are reluctant to have their entire refund deposited to a tax-preferred savings account like an IRA. And current IRS practice of only allowing taxpayers to direct their refund to one account actually reduces the portion of tax refunds that are saved. A recent pilot project suggests families could save under this proposal by simply checking a box on their tax returns to save part of their refund.

Mr. Chairman and distinguished members of this Committee, tax simplification transcends fiscal policy alone. It's also about priorities and values. Our tax system should respect the values and interests of middle class families.

Chairman MCCRERY. Thank you, Mr. Emanuel. Ms. Lofgren, I think you should reintroduce your bill, maybe next year. We probably won't act on it this year, but it seems to me that that is something we ought to look at. It does seem to be somewhat punitive, certainly in some cases, so I would encourage you to continue to pursue that. Don't get discouraged. It takes a while around here sometimes to address something. So, keep after it. We appreciate very much your coming before us today to point out what is a problem in your district. Certainly—as with many incentive stock options that are around in your district, but certainly everywhere across the country, that is a tool that companies can use and they want to use; and employees like it, so we ought not discourage the use of that through the tax treatment on the alternative minimum tax. The best solution, of course, would be to repeal the alternative minimum tax altogether, but we can't do that quite yet. So, we are working on it. Would you like to respond?

Ms. LOFGREN. Yes, thank you, Mr. Chairman. I, in the next Congress, with some encouragement, would happily pursue it. I would say, when I was contacted by these individuals in my district—because I do represent Silicon Valley—I assumed it was primarily a Silicon Valley issue. I was very surprised, therefore, to find out this is not just a Silicon Valley issue. There are people all over the United States who got incentive stock options. They saw their stock prices go under water in a year, and then they got hit with tax bills of $200,000, $300,000, $400,000, in one case $1 million on stock that they didn't receive a penny of value from. They tend to be people who are not the Chief Executive Officers, but the engineers or the administrative assistants, people who don't have certified public accountants looking over their shoulders. So, I would hope that the Committee could act. It is really a very compelling situation. I appreciate your kind comments.

Chairman MCCRERY. Thank you. Mr. Emanuel, this Committee has looked at the issue of corporate-owned life insurance. The Senate Finance Committee fairly recently adopted a number of reforms along the lines that you suggested. Are you familiar with those? Have you looked at those?

Mr. EMANUEL. Yes, I have. Some of them were—yes, I have.

Chairman MCCRERY. Do you think that they would solve the problems that you alluded to in your testimony? Or does more need to be done?

Mr. EMANUEL. Well, Mr. Chairman, if you were talking about the same type of reforms that they made, one was—I think their reform was on notification, so that the beneficiary and the family knew that there was a life insurance policy wrapped around the employee, so to say.

Chairman MCCRERY. Consent also.

Mr. EMANUEL. I do think that they don't—and I stand corrected if I am wrong, my understanding of it. I don't think they dealt with the tax provisions, as I outlined here, both for the purchase of the policy and the buildup inside.

Chairman MCCRERY. No, they allow that to continue.

Mr. EMANUEL. Right.

Chairman MCCRERY. They do require notification and consent of the employees.

Mr. EMANUEL. Right.

Chairman MCCRERY. They also limit the employees that can be included in the corporate-owned life insurance, which would do away with the janitors problem. So, maybe you should look at that. Let us know, after you have had time to thoroughly review it, if you think we still ought to just repeal the tax provisions that allow the company to deduct and then, of course, not pay tax on the buildup, the inside buildup.

Mr. EMANUEL. Right.

Chairman MCCRERY. Because, after all, as you probably know, companies have been using this tool for quite a number of years for what I think both you and I would agree is a good social policy to fund the benefits that the corporations pay to their employees. So, I am not sure that we want to throw that out, that tool out, without looking at it very closely.

Mr. EMANUEL. A, I have looked at what the Senate passed; B, I think it is good progress; C, I don't think the option is either you exist—you continue to exist the Tax Code as is. That means, if you end it somehow or reform it, you eliminate how the policy is used to fund other benefits for the company. I think there is a way to break bridges, too, so I don't think the taxpayers are out on the hook subsidizing what has happened in the past.

Chairman MCCRERY. Well, taxpayers subsidize a number of things.

Mr. EMANUEL. Yes, they do.

Chairman MCCRERY. They subsidize our health insurance, for example, and subsidize the health insurance of the General Motors employees at the plant in Shreveport. Again, I think we would agree that there is a pretty good social purpose there served by that tax deduction that the corporation enjoys and that tax exclusion that the employees enjoy.

Mr. EMANUEL. So, X pie is not a finite pie.

Chairman MCCRERY. That is something that this Committee has to grapple with all the time. I appreciate your remarks and your testimony. Mr. McNulty.

Mr. MCNULTY. Thank you, Mr. Chairman. I want to thank both of our colleagues for their testimony. I mentioned in my opening remarks that many times Members of this body work on various tax proposals over a very long period of time, and they tend to get lost in the shuffle when we consider these larger bills. That may have been the case in Ms. Lofgren's legislation. I would join with the Chairman in urging you to resubmit your legislation. We have no further questions on our side of the aisle, Mr. Chairman.

Chairman MCCRERY. Mr. Ryan? Mr. Brady? Well, thank you again. Mr. Emanuel, you did such a good job today in talking about the single definition of a child. That is actually going to be in the bill that is going to be on the floor this afternoon. So, you can take credit.

Mr. EMANUEL. Thank you both. I saw the press release out about a year ago.

Chairman MCCRERY. Thank you again.

Mr. MCNULTY. Mr. Chairman, I just wanted to make a unanimous-consent request. Because we were scheduled to hear from 20 Members of Congress today and 16 of them were actually able to make it here and present their testimony in person—there were four who did not—I would ask unanimous consent that the testimony of Mr. Hoekstra, Mr. Edwards, Mr. Saxton and Mr. Fossella are submitted for the record.

Chairman MCCRERY. Without objection. Is there any further business from any of the Members?

[The prepared statement of Mr. Hoekstra follows:]

Statement of The Honorable Peter Hoekstra, a Representative in Congress from the State of Michigan

Thank you Chairman McCrery for the opportunity to testify before you today on tax legislation that is important both to the nation's economy and to the efficient use of energy in the United States.

Last year, a constituent small business owner in Michigan's Second Congressional District brought to my attention a problem with the Tax Code, a problem that harms the environment and limits the economic vitality of an important American industry. The problem is that many of the heating, ventilation, air conditioning, and refrigeration systems installed in today's buildings are old, inefficient, harmful to the environment and need to be replaced. The average lifespan of an air conditioning system in a commercial building is 15 years, yet the Tax Code treats them as though their lifespan is 39 years.

The Tax Code specifies a depreciation schedule for HVACR systems of 39 years. That is more than double the average lifespan of these systems. The depreciation schedule in the Tax Code acts as a disincentive to invest and replace large, old and inefficient HVAC systems in commercial buildings.

Earlier this year, with bipartisan Members of the full Committee on Ways and Means as original co-sponsors, I introduced H.R. 3953, the Cool and Efficient Buildings Act.

This legislation would shorten the depreciation schedule for HVAC systems in commercial buildings to 15 years, to more accurately reflect the lifespan of these units.

This simple and common sense change would have a positive impact on the economy and the environment.

Reducing the depreciation period will provide an incentive for building owners to upgrade to more efficient equipment by allowing them to expense more of the costs of the systems each year. By replacing a building's existing units, building owners and managers lower energy costs and reduce energy demand.

The U.S. air conditioning and refrigeration industry employs more than 175,000 workers and contributes $17 billion annually to the U.S. economy. This U.S. industry exports $4.7 billion annually, providing an industry trade surplus of more than $2.1 billion.

Lowering the depreciation period to an accurate 15 years would encourage building owners to invest in new systems, creating business for American manufacturers and contractors.

Making this simple change in the Tax Code will improve the environment in two important ways. First, the replacement of old systems with newer, advanced technological systems greatly increases efficiency and reduces carbon dioxide emissions. New chillers are 34 to 42 percent more efficient than chillers installed 20 years ago.

Second, it would provide an incentive for the replacement of the 36,226 chillers still in use as of January 1, 2004, that use chlorofluorocarbon (CFC) refrigerants. This represents 45 percent of the original 80,000 CFC chillers banned from production in the United States in 1995 due to concerns over the impact of CFCs on the environment.

H.R. 3953, the Cool and Efficient Buildings Act, would make a common sense change to the U.S. Tax Code to the benefit of the U.S. economy and all Americans. I would like to express my appreciation to the 23 Members of Congress who have joined me in co-sponsoring H.R. 3953 and the various organizations that support this measure, including Air Conditioning Contractors of America; the Air-Conditioning and Refrigeration Institute; Associated Builders and Contractors; the Council for an Energy Efficient Economy; and Sheet Metal Air Conditioning Contractors National Association.

Mr. Chairman, thank you again for the opportunity to speak before your Subcommittee.

[The prepared statement of Mr. Edwards follows:]

Statement of The Honorable Chet Edwards, a Representative in Congress from the State of Texas

Mr. Chairman:

I come before you today to support H.R. 720, the Sales Tax Equity Act, an important piece of legislation I have cosponsored that was introduced by my colleague Rep. Kevin Brady, a leader who has worked hard to create an equitable Tax Code for all taxpayers.

This bill, H.R. 720, provides much needed tax relief for moderate and middle income families in my district by restoring the sales tax deduction Congress eliminated in 1986 to allow taxpayers in *all* states to deduct their state sales taxes. This would end the unfair discrimination against Texas taxpayers who do not have a state income tax and currently cannot deduct sales taxes on their federal income tax return. Residents of Texas, Florida, Washington, Tennessee, South Dakota, Nevada, and Wyoming pay more in federal taxes than residents of equal income in other states because these seven states do not have an income tax and cannot deduct sales taxes.

This bill restores tax equity by providing for the highest deduction: sales or income to be deducted from your federal tax return. Studies indicate that an average family of four can save nearly $300 off federal income taxes yearly under this proposal.

In Texas, State Comptroller Strayhorn estimates this legislation could create over 16,500 new jobs, $623 million in new investments, and $923 million in increased gross state product and other states could be expected to benefit comparably.

This provision has broad bipartisan support as well as the support of respected organizations such as the National Conference of State Legislatures, the National Taxpayers Union and the National Governors Association.

This is simple—the federal government simply has no right to discriminate against Texas taxpayers. And it should not be in the business of telling the state what to do with its tax decisions. A sales tax deduction would not only lower taxes for people in my district, it would result in more jobs, and a better overall economy.

The bottom line is that this bill treats taxpayers in all 50 states fairly and ends the federal bias against sales tax restoring equity among all taxpayers. It is the right thing to do for our citizens, our economy, and I hope you will carefully consider this important piece of legislation.

Thank you.

[The prepared statement of Mr. Saxton follows:]

Statement of The Honorable Jim Saxton, a Representative in Congress from the State of New Jersey

Mr. Chairman, colleagues, I thank you for your time today and for the opportunity to appear before you to discuss a matter of great importance.

I have recently introduced the Reservist Employment Act of 2004 and the Veterans' Employment Act of 2004 for the consideration of the 108th Congress. Similar in language, each of these bills offers a tax credit of 1,000 dollars to employers every three years for each veteran or reservist in their employment. With the implementation of these credits, this legislation would effectively promote the employment of those who have served in our nations armed services; and further support the many businesses that employ our veterans and reservists nationwide.

Although active in all sectors of America's economy, our veterans too often see limitations in the availability of civilian employment opportunities. While federal service positions offer some preferences to veterans, such provisions are not universal in private industry. For many seeking a position in the private sector, the search for employment proves long and arduous. With over 6 million of our veterans currently unemployed, these men and women need this assistance now more than ever.

During their time in the service, our veterans acquire personal attributes that private employers find imperative in today's business world. While serving in the armed services, these men and women consistently demonstrate a high level of adaptability; the ability to work within a team; a strong work ethic; and, more often than not, exemplary leadership qualities. Alongside the extensive technical and strategic training sustained during their service, the character displayed by our veterans should be sufficient to secure them steady employment. Unfortunately, we have been shown too often that this is not the case.

During my tenure in Congress, many of my constituents have expressed to me their frustration with the lack of availability of steady, well paid employment opportunities. Unlike their non-veteran contemporaries, they often find employers unfamiliar with the extensive training and experience accumulated during their years of service. With such skill sets and experience, our veterans most certainly deserve broader employment opportunities.

Similar to our veterans, our reservists are also finding immense challenges in the civilian job market. Now as never before, our reservists need assistance securing steady employment. Given their exemplary character and training, we cannot give private industry any justification for not hiring these men and women. As some of the most well trained and productive members of our workforce, our reservists' credentials should promote their ability to gain employment, not inhibit it.

Due to the limited time commitment typical of an inactive reserve member, full-time employment proves absolutely essential to nearly all of our reservists. Although many of them serve their country in federal service positions, most of our reservists seek employment within the private sector. While employers should be familiar with the responsibilities of our reservists, the War on Terror has greatly increased the possibilities of activation, and, in most cases, increased the nature of deployment.

Since the War on Terror began, the fundamental organization of our reserves has changed dramatically and will continue to do so as the war progresses. With increasing unpredictability in deployment, the stability of a reservist's participation in a civilian job has too been altered. As many employers rely heavily on their reservist employees, their temporary absence often proves detrimental to these businesses; and, although current law prohibits employers from terminating these individuals during activation, this provision does not correct the potential financial burdens these companies may sustain.

In a recent letter from one of my constituents, a small business owner expressed his dismay over the activation of his reservist employee. Hired for his exceptional engineering experience, this reservist represents what the employer deemed 'his company's most valuable asset.' With a staff of only four employees, this gentleman will potentially incur the loss of 25 percent of his workforce; and, although he may keep his business afloat through temporary employment, he will certainly suffer financial loss in the wake of this reserves absence. With such sacrifices from American businesses, we need to further ensure that our companies may amply withstand these setbacks.

In recent days, President Bush and his administration announced their continuing support for the employment protection of our reservists. While I applaud the President's resolve to improve employment protection for our troops, we, in Congress, must further this cause by passing legislation that encourages reservist employment.

In the midst of economic recuperation, the American economy has seen both an impressive rate of job creation and increasingly remarkable level of productivity. After months of economic uncertainty, the growth potential exhibited in recent months proves encouraging to the future development of American industry. While all areas of our government strive to support this recuperation, we do not want to inhibit this support with the disruption of our efforts over seas; nor do we wish to leave our service men and women out of such growth opportunities. As our troops protect the security of America's future abroad, I implore you to secure their future at home. Thank you.

[The prepared statement of Mr. Fossella follows:]

Statement of The Honorable Vito Fossella, a Representative in Congress from the State of New York

Not to be confused with Capital Gains, there is currently a deduction for Capital Losses incurred during a year. Under current law, taxpayers can deduct a maximum $3,000 from their investment losses. However, this $3,000 limit has not been increased or even adjusted for inflation since 1978.

In the 108th Congress, several bills have been introduced to update the law, including H.R. 572 (my own bill) and H.R. 4075 (that of Rep. Nick Smith). This issue is familiar to Ways and Means—towards the end of the 107th Congress a similar approach was endorsed by your Committee that would have updated and then indexed the law (H.R. 1619, on 10–8–02). Unfortunately, the House adjourned before the bill could be passed.

H.R. 572 will update the deduction to $8,250 and index it for inflation each year to come. This will save taxpayers and investors more than $2.1 billion this year and $24 billion over the next ten years. And not just investors, but anyone employed by investors or supported by investors will benefit—aiding the entire economy. Those hit by the economic downturn of the previous few years will be able to save a bit more of their own money to aid the financial recovery.

I understand the Ways and Means Committee has been swamped with work, particularly last year's crucial tax relief package, the Medicare Reform bill and the ongoing FSC–ETI debate. However, I am hopeful now is the time to revive this issue so that soon it can be passed into law. The marginal benefit to the economy during the recovery will pay large dividends.

As the economy and the stock market continue to accelerate, this is the perfect time to correct the law without significantly impacting the budget—fixing the roof before the next rainy season begins. The benefits will be felt most strongly by lower-income Americans, as they will appreciate the marginal increase in the deduction most.

Crucially, families that have lost money in 401k accounts will be able to deduct a bigger chunk of their losses to shore up their retirement funds. Today, 60% of adults are shareholders. More than 56% of the average family's financial assets are composed of stocks and mutual funds—16 points higher than a decade ago. 52% of all American families (representing 84 million people) are shareholders. It is critical that all these people not be unfairly burdened by the outdated Tax Code.

Given this increasing importance of stocks to the economy as well as government budgets, updating and indexing this deduction represents a solid opportunity to let taxpayers keep more of their money, while still not making it so large as to encourage irresponsible investment. I thank the Committee for their time and look forward to working with them in the future.

Mr. MCNULTY. Only the adjournment, Mr. Chairman.

Chairman MCCRERY. This hearing is adjourned.

[Whereupon, at 1:25 p.m., the hearing was adjourned.]
[Submissions for the record follow:]

Statement of Air Conditioning Contractors of America, Arlington, Virginia

The Air Conditioning Contractors of America (ACCA) is pleased to provide comments for the record in connection with the September 23, 2004 hearing of the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means on "Select Tax Issues." ACCA commends Chairman Jim McCrery (R–LA) and Ranking Member Michael McNulty (D–NY) for holding this important hearing to highlight tax issues from Members of Congress who do not sit on the House Ways and Means Committee.

ACCA represents the nearly 5,000 men and women who design, install and maintain heating, ventilation, air conditioning, and refrigeration (HVACR) systems across all 50 states. 75,000 employees in the HVACR industry are employed by ACCA member companies.

Currently, the federal tax code for the depreciation holding period for commercial HVACR equipment is 39 years. This is not beneficial to owners of commercial buildings because the equipment lifespan of properly maintained HVACR equipment is 15 to 20 years. As a result, commercial building owners have no incentive to replace older, less efficient equipment with newer, more energy efficient HVACR equipment because of the 39 year holding period. "The Cool and Efficient Buildings Act," H.R. 3953 sponsored by Representative Peter Hoekstra (R–MI), would resolve this problem.

H.R. 3953 reduces the 39 year depreciation holding period to a realistic 15 year depreciation holding period for HVACR equipment. Because most HVACR equipment has an optimum lifespan of 15 to 20 years, H.R. 3953 provides a realistic recovery period, thereby providing an incentive to commercial building owners to replace older equipment with new equipment.

In addition to providing a realistic depreciation schedule, H.R. 3953 also encourages energy conservation. In the past 15 years there have been dramatic changes in HVACR technology, making the equipment manufactured today extremely energy efficient. The HVACR systems now being installed in America's homes and businesses make obsolete many of the commercial heating and cooling systems in use today. Providing a financial incentive to building owners now would encourage them to upgrade to more energy efficient equipment instead of waiting until their obsolete equipment breaks down, which is the current practice today.

H.R. 3953 also provides the following benefits:

- New equipment to better manage indoor air quality, providing healthier indoor environments, which leads to less worker absenteeism and greater productivity.
- Higher efficiency equipment will greatly reduce carbon dioxide emissions.
- Increasing the turnover of outdated equipment will produce additional manufacturing and service jobs, thus further stimulating the economy.

Passage of H.R. 3953, the "Cool and Efficient Buildings Act," can help upgrade the nation's HVACR equipment and promote energy efficiency and savings. We applaud Representative Peter Hoekstra, as well as original cosponsor Representative Stephanie Tubbs Jones (D–OH), for sponsoring this legislation that creates jobs, provides healthier indoor environments and reduces carbon dioxide emissions. ACCA strongly urges the Subcommittee Members to consider this legislation that reduces the depreciation period of commercial HVACR equipment from 39 to a more realistic 15 years.

Thank you for the opportunity to submit this statement for the Record.

American Institute of Certified Public Accountants
Washington, DC 20004
October 7, 2004

The Honorable Jim McCrery
Chair, Subcommittee on Select Revenue Measures
1102 Longworth House Office Building
U.S. House of Representatives
Washington, DC 20515

The Honorable Michael R. McNulty
Ranking Member, Subcommittee on Select Revenue Measures
1102 Longworth House Office Building
U.S. House of Representatives
Washington, DC 20515

Dear Chairman McCrery and Ranking Member McNulty:

The American Institute of Certified Public Accountants (AICPA) is pleased to submit our statement in support of allowing small businesses the flexibility to adopt any fiscal year end from April through November for tax purposes, as proposed in the *Small Business Tax Flexibility Act of 2003* (H.R. 3225) for the record of the Subcommittee's September 23, 2004, hearing. We believe this bill will improve the Internal Revenue Code and will give small business start-ups the fiscal year options that will improve their chances of becoming productive, viable and valuable contributors to the American economy. Our detailed comments are attached.

The AICPA is the national professional organization of certified public accountants comprised of more than 350,000 members. Our members advise clients on federal, state, and international tax matters, and prepare income and other tax returns for millions of Americans. They provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

Small businesses are the primary source of the Nation's job creation and economic growth. To make these important contributions, start-up businesses must survive. Census data indicates that 20 percent of start-up businesses fail *after only one year*. After 10 years, 70 percent of these businesses no longer exist. Small Business Administration research indicates that most small businesses struggle with operational, financial, and tax problems. These problems dominate bankruptcy-filing statistics.

H.R. 3225 would give most small start-ups an additional tool to successfully navigate their turbulent beginnings—the flexibility to adopt any fiscal year-end from April through November. This flexibility would increase the prospects for a small business's survival by:

- Allowing increased productivity during peak business periods by easing record-keeping burdens.
- Increasing access to professional advisors by spreading the advisors' workloads out over more of the year.
- Granting access to marginal amounts of additional operating resources through short tax deferrals.

The seemingly straightforward requirement that most passthrough entity start-ups must use calendar year-ends creates unintended problems for new businesses passing their financial results through to their owners. Almost every one of these start-ups must—regardless of (1) when they began or (2) their natural business cycle—finalize their first-time financial and tax information during the busiest period for the very tax professionals they must rely on so heavily. By allowing these new and often-fragile businesses the flexibility to move their year-ends outside the regular "tax season," Congress could improve their chances for longer-term survival and support the newest small businesses that form the solid foundation of the American economy.

We appreciate the opportunity to continue working with the Subcommittee on Select Revenue Measures, the Ways and Means Committee, Congress, Treasury, and the IRS to reach our common goals of simplifying and improving our tax laws. We would be pleased to discuss this issue further at any time.

Sincerely,

Robert A. Zarzar
Chair
Tax Executive Committee

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS FISCAL YEAR FLEXIBILITY FOR START-UP SMALL BUSINESSES

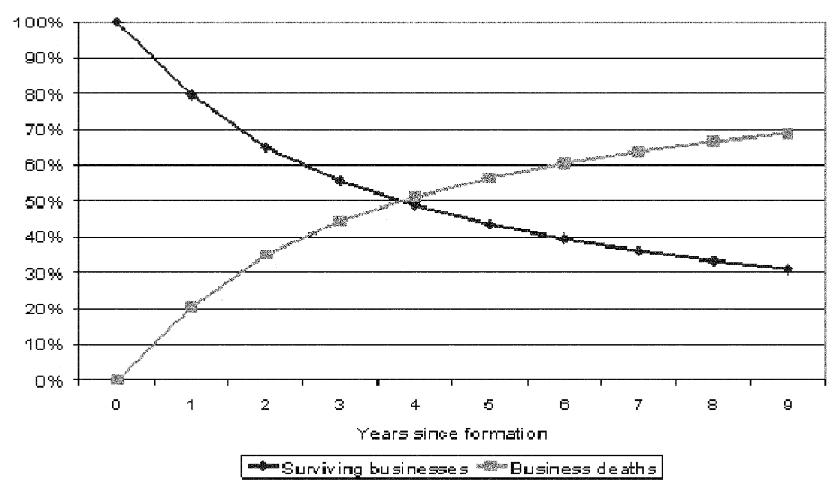
Overview

Small businesses are one of the main drivers of the Nation's job creation and economic growth. Start-up survivability is a critical area of concern that has been studied by the Small Business Administration [1] and others. Census data, as shown in the chart below, indicate that after only one year, 20 percent of start-up businesses have disappeared. After 10 years, 70 percent of these businesses no longer exist.[2] SBA research indicates that most small businesses struggle with operational, financial, and tax problems. These problems dominate bankruptcy-filing statistics.[3] H.R. 3225 proposes giving most small business start-ups an additional tool to successfully navigate its start-up life cycle by providing the flexibility to adopt any fiscal year-end from April through November. This flexibility would increase a small business's prospects for survival by:

- Allowing increased productivity during peak business periods by easing record-keeping burdens.
- Increasing access to professional advisors by spreading the advisors' workloads out over more of the year.
- Granting access to marginal amounts of additional operating resources through short tax deferrals.

ESTABLISHMENT SURVIVAL AND DEATH RATES

[For enterprises with 40 or fewer employees at time of establishment formation. Based on Census data for establishments formed in 1990 through 1995]



Current Law

Under current law only C corporations may elect any tax year of their choosing. However, S corporations and entities treated as partnerships—including most limited liability companies, general partnerships, and limited partnerships—(collectively, "flowthrough entities") generally must adopt a December 31 calendar year-end or the year-end of the flowthrough entity's majority owners, which is often De-

[1] FY 2001–2006 SBA Strategic Plan.
[2] "The Estimated Revenue Effect of H.R. 3225, the Small Business Tax Flexibility Act of 2003," PricewaterhouseCoopers LLP, October 2003.
[3] *Financial Difficulties of Small Businesses and Reasons for Their Failure*, SBA–95–0403, 9/98.

cember 31[4] unless a business purpose test[5] is met or unless a section 444 election[6] is made.

Reasons For Change

Requiring calendar year-ends for most passthrough entity start-ups creates an unintended problem for businesses passing their financial results through to their owners for inclusion in the owners' annual tax calculation. Applied to virtually every start-up small business in the country, these rules result in disruptive and unproductive demands on those businesses and their advisors during the same few months every year, and create an unnecessary pressure on start-up survivability. The substantial workload is compressed into the period from December through April. This "workload compression" often negatively impacts those who can least afford it: most small business start-ups that form a solid foundation for the American economy.

A high number of small business start-ups that will have less than $5 million of average annual revenues, and their advisors, are disproportionately burdened by this compression, especially in comparison with the very modest amount of the nation's taxable business income they generate.

In particular, start-up businesses need extra time and attention that is invariably scarce and that commands a premium during the so-called "busy season" from December through April. The first year of a business involves making critical decisions that have a significant influence on their ability to survive. These decisions include determining countless first year elections among the various available tax and accounting policies as well as establishing sound, compliant and correct business, accounting and tax procedures. In addition to other unavoidable calendar year-end responsibilities, start-ups must, for the first time, close their books, produce annual financial statements for their banks, conclude financial statement audits or reviews, and prepare tax returns and tax information for their owners well before April 15.[7]

Giving small business start-ups the flexibility to choose their fiscal year-ends will also facilitate their success in the following ways.

- **Allowing small business start-ups to spread their workloads and ease recordkeeping burdens by adopting a normal operating cycle year-end.** Most federal and state information and payroll reporting requirements must be satisfied on a calendar year basis—filing Forms 1099 and W–2, and their state equivalents—because these reporting requirements principally relate to non-owner calendar year taxpayers. Requiring entities to close their books, and where applicable, count inventory at the same time of year creates an additional and unnecessary burden on small businesses. Permitting start-ups to adopt a year-end coinciding with the low point of a business's normal operating cycle would allow their paperwork to be spread throughout the year and the new entrepreneurs to more closely focus on the success of the business, rather than its paper trail.
- **Maximizing their access to professional advisors.** Small, start-up businesses should be able to freely choose their advisors from the broadest possible spectrum of qualified advisors. H.R. 3225 helps spread out the workload for the advisors, such as CPAs, supporting these small business by providing critically needed advice, especially to new business operators who are generally less familiar with the full spectrum of business and tax responsibilities.

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[4] Section 806 of *The Tax Reform Act of 1986* required S corporations, personal service corporations and trusts to adopt calendar years. The 1954 Code already required all new partnerships to use December 31 year-ends.

[5] Partnerships or S corporations satisfying the business purpose tests under reg. sections 1.706(b)(1)(B)(i) and 1.1378(b)(2) may apply to use a "natural business year." However, the IRS grants few requests under the current, restrictive rules.

[6] *The Omnibus Budget Reconciliation Act of 1987* provided some relief from fiscal year conformity but further rate changes (from the then-28% highest rate to the now-35% highest rate) in the tax law soon thereafter made this relief impractical. Section 444 permits businesses to elect fiscal years, but requires electing entities to maintain a deposit with the Treasury Department equal to the amount of deferred income tax, calculated by multiplying the income deferred by the highest marginal individual income tax rate plus one percentage point. Few entities can utilize the election now because of the high cost and the limited deferral time permitted.

[7] The IRS has acknowledged the special needs of the small business constituency, including start-ups, by creating the Small Business/Self-Employed Division. The SB/SE will place a greater emphasis on pre-filing activities, such as education, and generally ensure that small businesses find tax compliance easier.

- **Providing marginal amounts of operating resources.** Adoption of a fiscal year would generally encourage capital formation through a modest postponement of tax liability for new, growing, successful businesses.

Expanding fiscal year options would also offer advantages to the government:

- **System processing efficiencies.** Our tax system must be efficient. Wasted efforts are a drag on the economy. Allowing small business start-ups to elect fiscal years would begin to spread the IRS's workload out as well by staggering the dates returns must be processed by the service centers. Further, requiring a huge number of passthrough entities to close their annual accounts at December 31 means that return preparers cannot physically complete a significant number of Forms 1065 or 1120S before the business' owners are required to file their individual returns on April 15. The result is an ever-growing number of Forms 1040 that must be extended each year, solely for lack of information from a passthrough entity. H.R. 3225 would reduce the need to extend the April 15 deadline for filing individual income tax returns because Schedule K–1 information returns from fiscal year partnerships and S corporations would be received earlier in the recipient's tax year. A start-up business (and therefore its owners) almost universally obtains a filing extension to September or October to use all available time to manage the new businesses first year tax filings. Staggered workloads would also allow tax professionals who play a critical role in the nation's self-assessment system to operate more efficiently.
- **Modest budgetary impact.** H.R. 3225 only affects a modest number of small entities and has a relatively small budgetary impact because the affected entities report only a small amount of taxable income to their owners.[8]
- **Focusing on consistency with other small business provisions.** Both Congress and Treasury have recognized the burden the tax laws place on small businesses and adopted Code and administrative provisions designed to ease this burden. H.R. 3225 is relatively simple and based on existing Internal Revenue Code rules and precedents. For example, section 448 permits entities with average gross receipts of less than $5 million to use the cash method of accounting, and section 179 permits small businesses to immediately write off the cost of some equipment. More recently, Treasury exempted entities with gross receipts under $1 million from the complex inventory rules, and there have been legislative proposals to increase this exemption to $5 million.[9]

Fiscal year conformity causes an unnecessary burden to small business start-ups that can be alleviated with modest changes to the tax system. Once relieved of these extra pressures, sound new businesses will have a greater chance of survivability and for success.

Explanation of Proposal

H.R. 3225 amends the Code by permitting a "qualified small business" to elect any fiscal year ending on the last day of April through November (or at the end of an equivalent annual period (varying from 52 to 53 weeks)). Only a new business entity can be a "qualified small business" and it must elect its fiscal year in its year of formation. Specifically, a "qualified small business" is any entity that:

1. Is a newly formed S corporation or a newly formed entity treated as a partnership for federal income tax purposes;
2. Conducts an active trade or business;
3. Is a "start-up business"; and
4. Meets a gross receipts test.

An entity would qualify as a "start-up business" only if no more than 75% of the entity is owned by any person who previously conducted the same trade or business any time within the previous 12 months. For attribution of ownership purposes, husbands, wives and minor children (under age 21) are considered one owner.

An entity would meet the gross receipts test if its average gross receipts do not exceed $5 million. Existing rules under section 448(c) (3-year test) would be used to determine an entity's average gross receipts. Accordingly, when an entity's life

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[8] IRS 1992 Statistics of Income (SOI) data indicated that 77.03 percent of S Corporation returns with positive income report net income below $50,000, representing, cumulatively, only 11.66 percent of the total positive net income reported on Forms 1120S. 1992 SOI data also indicated that 69.63 percent of partnership returns with positive income report net income below $50,000, representing, cumulatively, only 5.63% of the total positive net income reported on Forms 1065. New businesses represent a small fraction of this income.

[9] For example, see H.R. 1037, the *Small Employer Tax Relief Act of 2001*.

is less than 3 years, the number of years of existence would be used. In the case of the sale of a capital or section 1231 asset, the gain on the sale (not gross proceeds) would be used in determining average gross receipts. Multiple businesses and complex ownership structures would be aggregated into a single "qualified small business" using the anti-abuse rules of sections 448(c)(2) and 267 (b) and (e).

Entities that are not "qualified small businesses" or that cease to qualify (trusts, personal service corporations and flow-through entities that are small businesses owned by large partnerships, S corporations, or C corporations) would determine their fiscal years under existing rules—a "required" taxable year; a "natural" business year; or a "permitted" fiscal year as elected under section 444.

When the average gross receipts of an otherwise "qualified small business" exceed $5 million, it must either elect to maintain a deposit under section 444 or convert to a permitted year-end under existing rules. The entity would report items resulting in net profits from its last fiscal year-end to December 31 ratably over the shorter of either the number of years its fiscal year was in effect, or four years. Net losses would be deducted in the year of change. This would mirror existing transition rules under sections 448 and 481, and Rev. Proc. 2002–13. Appropriate conforming amendments would also need to be made to sections 444, 706, and 1378.

Under this legislation, each "qualified small business" would have only one automatic opportunity to adopt a fiscal year. A qualifying entity would have to elect a fiscal year for its first year of operation on the entity's first filed return of income or default to a year allowable under current law.

Statement of Andrew Kohn, American Prepaid Legal Services Institute, Chicago, Illinois

I am Andrew Kohn, President of the American Prepaid Legal Services Institute. The American Prepaid Legal Services Institute (API) is a professional trade organization representing the legal services plan industry. Headquartered in Chicago, API is affiliated with the American Bar Association. Our membership includes the administrators, sponsors and provider attorneys for the largest and most developed legal services plans in the nation. The API is looked upon nationally as the primary voice for the legal services plan industry.

The hearing today deals with select tax issues. Subcommittee Chairman McCrery noted in calling the hearing that it is important to hear from non-committee members to discuss tax policies of interest to their constituents. I offer this written testimony in support of H.R. 2031, co-sponsored by Representatives Tom Cole and Brad Carson, from Oklahoma, as well as H.R. 973 offered by Representative Dave Camp and co-sponsored by 39 other Representatives. The bill amends the Internal Revenue Code of 1986 to restore and make permanent the exclusion from gross income for amounts received under qualified group legal services plans.

This provision, originally enacted in 1976 and extended on seven separate occasions between 1981 and 1991, encourages legal services benefits for employees and their families by excluding from income and social security taxes employer contributions towards qualified group legal services plans. Unfortunately, when this exclusion expired, it triggered a tax increase for millions of working Americans whose employers contribute to such plans. Currently employees and retirees are taxed on the employer's contribution, whether or not they use the benefit.

Large and small employers support group legal plans. The plans improve productivity by enabling employees to resolve legal difficulties early on before they become more complex, time consuming and expensive. By offering an inexpensive and efficient benefit, small employers can compete with larger employers for hourly wage workers.

These plans are also important to employees. With the growing complexity of today's world, ordinary citizens need access to preventive legal advice. Group legal plans provide employees with low cost basic legal services, including assistance with the purchase of a home, the preparation of a will, probate services, the resolution of domestic relations difficulties, such as child support collection. Many plans also offer assistance with elder care issues and the growing problem of identity theft. Plans generally do not allow for suits against the employer, class actions or fee generating cases.

More than 8 million working Americans and their dependents are now covered by legal plans. They are offered by such national companies as Caterpillar, DiamlerChrysler, J.I. Case, Mack Truck, John Deere, Ford Motor Company, General Motors, and thousands of small businesses.

Many people do not realize that Group Legal plans cover not only active workers but also cover retirees and surviving spouses. For example, one group of 26 auto manufacturing companies alone, including Ford, GM, DaimlerChrysler, American Axle, Delphi and Visteon and others, provide a group legal benefit for 475,000 retirees and surviving spouses.

In fact, much of the legal work done by legal plan attorneys is designed either to prepare workers for retirement or to handle issues that arise after retirement.

Retirement is a complex task today. Those individuals anticipating retirement must consider how to:

- Protect their spouses and children in the event of death.
- Anticipate the need for nursing home care, as well as Medicare and Medicaid issues.
- Instruct medical professionals on how they want to be treated in the event of a serious illness or a life threatening accident.
- Instruct family members on how they want their property handled in the event of incapacitating illness or accident.
- Address financial issues in the face of a decreased income.

Legal plans provide the advice and legal documents to accomplish these tasks including wills and trusts, powers of attorney, living wills/medical directives, guardianship and conservatorships, nursing home contract review, Medicare and Medicaid appeals and home refinancing document review. To implement a comprehensive financial and retirement plan, legal documents must be drafted; legal plans provide this service quickly and economically. These important legal services provide retirement security.

Legal plans also provide a significant educational benefit on a multitude of issues important to working and retired Americans and are a vital component of any retirement education plan. Legal plans:

- Educate consumers about budgeting and debt problems.
- Present seminars on preparing for retirement covering estate planning, social security and review of IRA's, including such issues as what to do with the IRA when the first spouse dies.
- Educate clients on how to avoid identity theft and what steps to take if a client is a victim of this crime.

While qualified employer-paid plans have proven to be highly efficient, there is still a cost to the employer for providing this aspect of retirement security. Employers must pay an additional 7.65 percent of every dollar devoted to a legal plan as part of its payroll tax, whether for an active employee or a retiree. Both employees and retirees are taxed on the benefit whether they use it or not in any given year.

As employers seek to reduce or eliminate benefits in general, targeting benefits that are not tax preferred are high on employers' lists. Recently this trend toward reducing benefits has taken a toll on existing group legal plans. Large employers such as Rouge Steel, Delphi and Visteon have either dropped the benefit entirely or created a two-tier benefit system that eliminates group legal for their newest employees. The lack of a tax preference for group legal plans makes the benefit vulnerable for reduction or elimination by employers.

Benefit to retirees and the value of the legal services far exceeds the cost of the plan. Many a retiree has commented that without a legal plan they did not have the money to hire an attorney to solve their legal problem, which could be as serious as defending against a wrongful foreclosure. Yet plans with retirees are the most vulnerable. In more mature industries, far fewer active workers exist to support the retiree community. These so called "legacy costs" drive the efforts to reduce costs.

Still employers can provide a substantial legal service benefit to participants at a fraction of what medical and other benefit plans cost. For an average employer contribution of less than $100 annually, employees and retirees are eligible to utilize a wide range of legal services often worth hundreds and even thousands of dollars, which otherwise would be well beyond their means.

H.R. 973 and H.R. 2031 are identical and include a straight-forward proposal which would repeal this tax increase, restore equity to the tax treatment of this benefit and ease the administrative burden on employers. This will also demonstrate to small and large businesses and the millions of hard-working low and middle-income workers, not only that this Congress supports them, but that the tax code can be beneficial for them.

Statement of The Bond Market Association

The Bond Market Association appreciates the opportunity to propose ways to simplify and improve the U.S. tax code. The Bond Market Association represents securities firms and banks that underwrite, trade and sell debt securities both domestically and internationally. The Association's membership accounts for approximately 94 percent of the nation's bond underwriting activity.

We commend Chairman McCrery for considering the question of simplifying and improving the tax code and requesting public input. As representatives of the $1.9 trillion municipal bond industry, The Bond Market Association is focused on those changes to the current tax code that would promote the most efficient use possible of the tax exemption for municipalities Congress created 91 year ago. Every year, state and local governments save tens of billions of dollars in interest expense due to the tax exemption. This savings makes it possible to finance schools, roads, airports, environmental infrastructure, low-income housing and a variety of other capital projects affordably and efficiently. States and localities currently face significant fiscal constraints brought about by a weak economy, a poorly performing stock market and increasing pressures on spending. The ability to realize even more savings through a more efficient tax code is more important than ever to state and local governments.

In response to Chairman McCrery's request for proposals to simplify and improve the tax code, the Association proposes a number of common sense changes to provisions that, in one form or another, put restraints on the municipal bond market. Over the past decades, the tax code has generated rules that unnecessarily limit the use of proceeds of tax-exempt bond issuance as well as limit the market for these securities. Both of these outcomes drive up the cost of borrowing for our nation's states and municipalities. The following proposed changes would simplify the tax code, reduce compliance costs and make the municipal bond market more efficient, which will lead to lower state and local borrowing costs. While this statement presents several longstanding Association initiatives to simplify the code as it relates to tax-exempt bonds, we look forward to a continuing dialog with subcommittee members on a broader group of legislative tax issues affecting tax-exempt bonds as well as other sectors of the bond markets.

Overhaul the AMT

Congress enacted the alternative minimum tax (AMT) in 1969 to ensure all corporate and individual taxpayers pay at least a minimum level of taxes. As is sometimes the case with tax policy, however, the AMT threatens unintended consequences. Because the standard income exemption amount under AMT is not indexed to inflation, the Congressional Budget Office estimates the number of individual taxpayers subject to the tax will grow to 30 million by 2010, up from 605,000 in 1997.

The unintended consequences of the AMT also reach the municipal securities market effectively increasing the cost of financing public projects for state and local governments. In considering AMT reform, Congress should look not only at the direct effect on individual taxpayers, but also the indirect effect of higher public borrowing costs.

Municipal securities are typically exempt from taxation with the exception of private-activity bonds whose proceeds benefit a private party for an approved project and whose source of repayment comes from a private source. Private-activity bond interest is subject to both the individual and corporate alternative minimum tax. This means investors—should they fall under the AMT—will owe a tax on what would otherwise be tax-exempt income. To offset this risk, both individual and corporate investors in private-activity bonds demand a yield premium that has averaged 25 to 40 basis points, over time.

In addition, the corporate AMT limits demand for municipal bonds among property and casualty insurance companies (P&C) who—due to tax code restraints on other corporate investors—are the major source of corporate investors in municipal bonds. The Internal Revenue Code also subjects a portion of interest on public purpose tax-exempt bonds and on tax-exempt bonds issued on behalf of tax-exempt 501(c)(3) organizations to the corporate AMT. Since 1990, 75 percent of the interest on public purpose and 501(c)(3) bonds have been subject to the AMT under the "adjusted current earnings" provisions. The corporate AMT rate is 20 percent so corporations affected by the AMT effectively pay a tax rate of 15 percent on tax-exempt interest on public purpose and 501(c)(3)bonds.

The after-tax return on municipals for corporations who pay the AMT is low relative to other investment options for P&Cs who find themselves under the AMT, rather than the ordinary corporate income tax. This creates an incentive for P&Cs

to sell municipal bond holdings as they approach a point where they should be subject to the AMT. This effect is particularly pronounced in times such as the aftermath of a major natural disaster when P&Cs must sell assets to pay inordinately high damage claims. Ironically, such claims tend to cause P&Cs to become AMT payers. Excess AMT liability can be carried forward as an ordinary income tax credit in future years. Under some conditions, this could cause P&Cs to stay out of the municipal bond market for years.

The yield premium created by the narrowing of demand for private-activity bonds translates into higher borrowing costs for the states and localities that issue private-activity bonds to finance projects. And, if current trends continue, the premium is likely to rise. As more and more investors fall under the AMT, the pool of private-activity bond investors grows smaller. Until the problem is addressed by Congress, either through a broad-based reform or a targeted exemption for private-activity bonds, decreased demand for these bonds will continue to put upward pressure on yields and raise the cost of financing public projects.

One approach to addressing problems with the individual AMT would be to address the overall policy problem of a lack of indexing for the AMT exemption. This approach would mitigate, but not, however, solve problems raised by applying the individual AMT to private-activity bond interest. The best approach for Congress would be to eliminate the application of the AMT to private-activity bond interest. It is likely that such an approach would have little to no affect on federal revenues, since few AMT payers buy private-activity bonds.

Repeal of the 10-Year Rule for Mortgage Revenue Bonds

State and local housing finance agencies (HFA) will lose an estimated $12 billion in mortgage authority, or the equivalent of about 150,000 mortgage loans, by 2005 unless the 10-year rule is repealed. The 10-year rule requires HFAs to use principal repayments and prepayments from mortgages to retire mortgage revenue bonds (MRB) that are more than 10 years old rather than make new mortgage loans to low- and moderate-income homebuyers. The Association supports legislation to repeal the rule.

In 1988, Congress anticipated the end of the MRB program and enacted the 10-year rule in an effort to terminate the tax-exempt bonds associated with the program. But Congress did not end the program in 1988 as expected and in 1993 made the MRB program permanent. Now, 16 years later, HFAs are losing billions of dollars in mortgage authority because of the 10-year rule's prohibition on re-lending mortgage repayments. HFAs prefer to use the repayments to make new mortgage loans or to refund existing bonds to finance new mortgage loans.

Giving the agencies more flexibility with the use of mortgage repayments by repealing the 10-year rule will increase the mortgage authority of HFAs in two ways. The repayments can be re-loaned as new mortgages. Or, given favorable interest rates, HFAs can use the repayments to refund outstanding bonds and make more loans at lower rates.

In periods of lower interest rates, prepayment rates on home loans tend to rise as homeowners try to save money through refinancing. Similarly, lower interest rates offer HFAs the chance to save on interest costs through a refunding, the process of issuing a new bond at a lower rate and using the proceeds to retire the existing higher-rate bonds. Repealing the 10-year rule would allow HFAs to leverage repayments this way by making new mortgages with the proceeds of the refunding. As a result, a larger volume of mortgage loans would be available for families that would otherwise have a difficult time borrowing in the conventional mortgage market.

Pending legislation to repeal the rule, introduced in both the House and the Senate, has garnered significant support. H.R. 284 currently has 350 cosponsors; S. 595 has 72. During the 107th Congress, identical legislation had 360 cosponsors in the House and 75 Senate cosponsors.

Small-Issuer Arbitrage Relief

Arbitrage regulations under the U.S. tax code limit the rate of return issuers of tax-exempt bonds can earn on the proceeds of tax-exempt bonds. Issuers—particularly those using bonds to finance construction—need to keep bond proceeds in an escrow account. The earnings on these escrow accounts must be disclosed to the IRS in a filing to determine whether the issuer must rebate any "arbitrage" to the government. This arbitrage rebate calculation is complicated and expensive. For that reason, school districts that issue bonds for construction have been exempt from the rebate rule if their total issuance is less than $10 million annually with at least $5 million devoted to school construction. This issuance limit for small issuer arbitrage rebate exemption should be increased to $15 million provided that at least $10 million of that total finances school construction and then indexed to inflation to keep pace with rising construction costs. The Association does not advocate changes to the rules on yield restrictions.

Extend the Construction Spend-Down Period

As long as a local government spends the proceeds of a bond issue on a construction project according to a schedule where virtually all the proceeds are spent within two years, that bond is not subject to certain arbitrage rebate rules. This exemption is useful in reducing the cost of state and local construction projects. However, the two-year schedule often limits the usefulness of this exemption for municipalities that undertake multi-year construction and financing plans. Congress should extend the construction spend-down exemption from two years to four for bonds issued to finance the construction of public projects.

Increase Access to Industrial Development Bonds

Under current law, an issuer is eligible to use "small issue" industrial development bonds—to finance small, job-creating manufacturers—if their total capital expenditure during the six-year period around the date of issuance does not exceed $10 million. This figure was set 25 years ago and since then its purchasing power has declined 50 percent. Congress should double the IDB capital expenditure limit to $20 million and index the amount to inflation ensuring this important financing tool will remain useful to small manufacturers in the future. A similar proposal is currently pending before Congress and is under consideration as part of H.R. 4520, the "American Jobs Creation Act of 2004."

Conclusion

The Bond Market Association appreciates the opportunity to share with the Subcommittee our members' views on simplifying and improving the tax code. All of the foregoing proposals, if adopted, would improve the efficiency of the tax code and serve to lower the financing costs of tax-exempt bond issuers.

Statement of Timothy J. Carlson, Coalition for Tax Fairness, Arlington, Virginia

The Alternative Minimum Tax ("AMT") has received substantial negative press because of its many anomalous provisions; in some cases, it is forcing taxpayers into bankruptcy by imposing tax rates of 300% or more of their income. While we recognize that a repeal of the entire AMT, even a repeal of certain AMT provisions, may not be feasible at this time, it is imperative that Congress focus on those taxpayers whom the AMT's unintended consequences are most seriously harming, and rectify the AMT's most dangerous provision, the Incentive Stock Option ("ISO") rule. Therefore, as an organization devoted to resolving the AMT/ISO problem, we offer below a recommendation that would allow the Congressional purpose of the AMT to remain intact while providing a simple, principled, and equitable solution to the problem, for all taxpayers.

I. *Background*

During the 1990s, many employers offered ISOs as compensation to attract more talented employees than they could otherwise afford. Congress encouraged this type of employee investment in their companies and in the economy by creating tax rules that did not tax ISOs upon their exercise and encourage a quick sale, but instead rewarded taxpayers by offering the more favorable capital gains tax rates to those who held their stock for one year.

Due to the complexity of the AMT, most specifically the ISO provision, the AMT eliminated these benefits without any warning and sent taxpayers into a downward spiral from which many have yet to recover. The AMT taxed the transaction on the exercise date as though the taxpayer actually sold the stock immediately and realized a gain, even though he did not receive any actual gain; the AMT caused these massive prepayments on phantom income. Although the language of the AMT provides for a credit related to these prepayments, for these entrepreneurs and company employees subjected to this AMT, the prepayments have become interest-free loans to the Government that, due to further quirks in the law, will never be repaid or credited. Those taxpayers who do not have the resources to make these massive interest-free loans to the Government are incurring interest and penalties. Many have lost (or are in the process of losing) their homes, retirement savings, and college savings—while the prepayments they are making build up more useless tax "credits." Those who exercised ISOs, in the years 1999–2003 especially, and did not immediately sell (in many cases upon the advice of their trusted advisers) continue to suffer greatly at the hands of the AMT. Adverse market conditions and a conflict between the tax and securities laws have exacerbated the problem.

II. *Summary of Proposal*

The proposal contained herein will alleviate current and future suffering through targeted and principled measures that will prevent similar results from occurring in the future. Our proposal better matches the regular tax code's incentives with the AMT's enforcement goals, as follows:

- *Immediate Relief*: Although the proposal summarized immediately below presents a comprehensive solution, in the time it takes for this proposal to become law, many taxpayers affected by the ISO provision will lose their homes. The IRS erroneously has taken the position that it is required to enforce the letter of this law, without compromise. Congress has already begun efforts to compel the IRS to temporarily halt enforcement of this provision or enter into offers-in-compromise, and must continue support of these efforts.
- *Valuation Date*: This proposal matches (a) the date on which the AMT values the "economic gain" earned through the exercise of ISOs with (b) the date on which the underlying stock becomes a long-term capital asset (the later of two years from grant, or one year from exercise). Currently, the AMT values the "gain" on the day of exercise, ignoring any subsequent changes in valuation.
- *Sale of Stock*: This proposal allows the taxpayer to follow Congress's intent and hold the stock until it becomes a long-term capital asset. Taxpayers can then satisfy their AMT and regular tax liability by paying the correct proportionate amount of the sale proceeds. Under current law, the AMT may force (a) an early sale of stock, subjecting the taxpayer to higher ordinary income tax rates, or (b) a later sale of depreciated stock. In either case, the proceeds of the sale may be insufficient to satisfy the AMT liability.
- *AMT Credit*: This proposal synchronizes the return of stock-generated AMT credit (prepayment of regular tax), with the stock's sale. This appropriately matches true economic gain taxed under the AMT with the results correctly determined under the regular tax code.
- *Voluntary Compliance*: This proposal will be correctly recognized by taxpayers as equitable, but further reinforces compliance by providing for corporate "matching" reporting to the IRS of employees' ISO exercises, thereby increasing voluntary compliance and ensuring everyone pays their fair share. Additionally, this proposal encourages those who have failed to report past ISO exercises to come forward and report such exercises in the current year. This measure serves to increase the amount of revenues collected, without significant enforcement efforts. A provision is proposed to prospectively institute mandatory reporting of ISO exercises, without any additional administrative cost, thereby substantially increasing tax revenues.

The AMT's application to ISOs is causing unintended, egregious, and devastating tax burdens on honest taxpayers, and hobbling the very entrepreneurial drive that has made small business a powerful engine of the U.S. economy. If a change is not made, this situation will recur and worsen. This proposal addresses the unintended and unfair consequences being suffered by these and other taxpayers, so citizens can spend their ambition, time, and effort growing the U.S. economy—rather than fighting unjust tax laws.

This proposal's overarching goal is to maintain the AMT as a separate tax system and to tax (so-called) economic wealth on a current basis. It also reflects Congress's intent regarding the purpose and prevalence of ISOs in today's marketplace. By synchronizing the disconnects between the regular tax and the AMT's treatment of ISOs, this proposal preserves the AMT's prepayment aims while helping entrepreneurs return to a position of bolstering this nation's economy. We urge you to adopt this recommendation, for the good of the economy and to give taxpayers the fair treatment they deserve.

III. *Details of Proposal*

This proposal would (A) provide immediate relief to affected taxpayers, pending enactment of further legislation, and (B) amend the Internal Revenue Code of 1986 to (a) synchronize the AMT prepayment rate imposed on the exercise of ISOs with the tax rate to which any gains are subject upon the sale of such stock; synchronize the AMT valuation date with the date upon which the stock becomes a long-term capital asset, thereby ensuring that the AMT prepayment rate does not undermine Congressional intent to encourage long-term stock ownership and the building of shareholder value; and accelerate the AMT credit to better reflect Congress's original intent in enacting the AMT provisions; and (b) provide fair and just relief to taxpayers (1) who are currently unable to prepay the full AMT arising from their exercise of ISOs, or (2) who have prepaid a significantly disproportionate AMT arising from their exercise of ISOs, due to the subsequent unprecedented drop in stock values and the unintended resulting imposition of an AMT on phantom value that the taxpayers never realized, at a higher rate than Congress intended. The proposal will also add a measure to increase voluntary taxpayer compliance and the amount of revenues collected.

SECTION 1. Offers-In-Compromise.

Concept: Immediately resolve, or otherwise provide instructions to the Internal Revenue Service and Department of the Treasury, that the IRS and Treasury must utilize the flexibility Congress provided the IRS under current law: the Special Circumstances and Effective Tax Administration provisions of the Offer-in-Compromise ("OIC") process. The IRS categorically and publicly refuses to consider these cases under the OIC procedures, regardless of the facts, and action is needed to ensure the IRS properly administers these rules. The IRS's administration of the OIC procedures have been under scrutiny by bodies including the House Ways & Means Oversight Subcommittee, the Senate Finance Committee, the National Taxpayer Advocate, and the American Bar Association Section of Taxation, and action must be taken immediately.

SECTION 2. For exercises taking place in 2004 and thereafter.

Concept: Amend, as appropriate, sections 56 through 59 of the Internal Revenue Code to provide that:

(a) *Value*: For AMT purposes, the value of the deemed income generated from the exercise of ISOs will be determined as of:

(i) the date that is the later of (A) two years from the date of the ISO grant, or (B) one year from the date on which the ISO stock was transferred to the employee upon ISO exercise ("the anniversary date"), under rules similar to those under § 422(a)(1), or

(ii) the date of disposition ("the earlier disposition date"), if earlier.

(b) *Year of Inclusion*: The date determined in paragraph (a) in turn will determine the year in which such value is included in AMT income.

(c) *Tax Rate*:

(i) *General Rule*: The tax rate on the value of the deemed income generated from the exercise of ISOs should reflect the tax rate that would apply under the regular tax code upon a disposition of such shares on the valuation date, whether that be the anniversary date or the earlier disposition date.

(ii) *Earlier Disposition Date*: If the value is determined as of the earlier disposition date, then the disposition is a "disqualifying disposition" as currently defined in the AMT provisions, and the income generated by such disposition is taxed as ordinary income in the year of the disposition. This provision matches the value, year of inclusion, and tax rate to the consequences under the regular tax code. This reflects no change from existing AMT rules to the extent the early disposition date takes place in the year of exercise.

(iii) *Anniversary Date*:

(A) If the value is determined as of the anniversary date, then the shares are deemed sold on that date, and the income deemed generated by such sale is taxed as long-term capital gain in the year of the deemed sale. This provision strikes a balance between the AMT's need for currency of taxation and the regular tax code's recognition of the economic benefits of long-term investing.

(B) As under current AMT rules, at the time of the deemed sale, the basis in those shares increases to the amount of the deemed sale. Effectively, the shares have been deemed sold, income paid on the deemed gain, and then the shares are immediately repurchased.

(iv) *Adherence to Future Changes*: The intent of this provision is to better align the Congressional intent regarding the AMT with the Congressional intent regarding capital assets and incentive stock options. Therefore, should the future bring changes to the capital gain structure, in terms of timing, asset characterization, or otherwise the aforementioned provisions should likewise be changed.

(d) *AMT Credit for Taxable Years Subsequent to Year of Inclusion*: Currently, the payment of any AMT generated by the inclusion in AMT Income of "economic income" from the exercise of ISOs will result in an AMT Credit, creditable against regular tax liabilities in subsequent years, to the extent such regular tax exceeds the AMT. As described below in greater detail, this AMT Credit may take decades or centuries to be fully refunded under the current rules. Under this proposal, any portion of the AMT Credit currently remaining and attributable to the exercise of

ISOs shall be fully refunded to the taxpayer upon the actual disposition of the stock. To the extent the taxpayer has disposed of only a portion of the stock, an appropriate portion of the AMT Credit shall be refunded. In this manner, the AMT Credit maintains much of the same operation, and generates the proper amount of refund in the year of ultimate disposition. At the same time, it better matches the intent of Congress. At most, this proposal merely pulls forward the payment date of the intended credit to bring about a rational result.

SECTION 3. For prior exercises.

Concept: Amend, as appropriate, sections 56 through 59 of the Internal Revenue Code to provide that:

(a) *Affected Taxpayers*: Any taxpayers who exercised ISOs during prior calendar years are eligible to elect relief under this provision. The intent of this provision is to provide relief, similar to that described above, to taxpayers whose AMT liabilities failed to reflect actual "economic income" and who currently have outstanding AMT liabilities or AMT credits attributable to the exercise of ISOs.

(b) *AMT Income*:

(i) *Disposition During Calendar Year of Exercise*: Taxpayers who disposed of the acquired stock during the calendar year of exercise have already included the proper amounts of income in their AMT and regular income, during the proper year, and at the proper rate. Thus, no correction is necessary to AMT income or timing. However, to the extent any AMT Credit was generated from this exercise and remains outstanding, it shall be fully refunded in the current year.

(ii) *Disposition After Calendar Year of Exercise*: Taxpayers who held the acquired stock beyond the end of the calendar year of exercise, but who disposed of such stock either (a) prior to holding the stock for one year, or (b) after holding the stock for one year but prior to December 31, 2003, have already included amounts of income in their AMT and regular income, but the timing, rates, and amounts of each such inclusion are not in agreement.

(A) To the extent any AMT Credit was generated from this exercise and remains outstanding, a result similar to that described in Section 2 above shall be afforded to these affected taxpayers in the current year (i.e., taxpayers shall receive a full refund of any remaining outstanding AMT credits associated with such stock).

(B) To the extent any tax liabilities remain outstanding with respect to the exercise, a result similar to that described in Section 2 above shall be afforded to these affected taxpayers in the current year (i.e., any outstanding tax liability in excess of the amount which would be due under a method consistent with Section 2 above, using the disposition date as the valuation date, shall be abated).

(C) Similarly, to the extent any interest or penalties have been paid (or accrued but unpaid) by taxpayers with respect to the exercise, a result similar to that described in Section 2 above shall be afforded to these affected taxpayers in the current year (i.e., any interest or penalties paid (or accrued but unpaid) in excess of the amount that would be due under a method consistent with Section 2 above, using the disposition date as the valuation date, shall be refunded (or abated)). This merely relieves the interest and penalties attributable to the unfair, and mitigated, portion of the tax under the current AMT/ISO provision; to the extent interest or penalties were paid (or accrued but unpaid) on the portion of the tax under the proposed AMT/ISO provision, the payments (or accruals) are not refundable (or abatable).

(iii) *Holdings on December 31, 2003*:

(A) Taxpayers who exercised the ISOs during a prior year but who did not dispose of the acquired stock prior to December 31, 2003 may elect to treat December 31, 2003 as their anniversary date, with the consequences described in Section 2 above.

(B) Because these affected taxpayers included an amount in AMT income during the year of exercise and accordingly increased the basis in the acquired stock, the deemed disposition described in Section 2 above will create a deemed loss with respect to the stock. This "deemed loss" shall result in a lower basis in the retained stock, but no loss shall be recorded. Rather, to the extent any AMT Credit was generated from this exercise, a result similar to that described in Section 2 above shall be afforded to these affected taxpayers in the current year (i.e. they shall receive a full refund of any excess AMT credits associated with such stock to the extent such AMT credits exceed the AMT tax due for such stock as calculated on December 31, 2003 at the capital gains rate).

(1) To the extent any tax liabilities remain outstanding with respect to the exercise, a result similar to that described in Section 2 above shall be afforded to these affected taxpayers in the current year (i.e., any outstanding tax liability in excess of the amount which would be due under a method consistent with Section 2 above, using December 31, 2003 as the valuation date, shall be abated).

(2) To the extent any interest or penalties have been paid (or accrued but unpaid) by taxpayers with respect to the exercise, a result similar to that described in Section 2 above shall be afforded to these affected taxpayers in the current year (i.e., any interest or penalties paid (or accrued but unpaid) in excess of the amount that would be due under a method consistent with Section 2 above, using December 31, 2003 as the valuation date, shall be refunded (or abated)).

SECTION 4. For increasing voluntary compliances and revenues.

Concept: *Increased Future Compliance*: Amend, as appropriate, sections 56 through 59, 421 through 422, and/or 6039 of the Internal Revenue Code to provide that:

(a) Section 6039(a) currently requires corporations to furnish certain information to taxpayers who acquire stock through the exercise of ISOs. To increase voluntary compliance with the AMT provisions, that notice shall be copied to the IRS and the exercising taxpayer shall be notified of such copy.

(b) The intent of this provision is to provide the IRS with the necessary enforcement tools not present under current AMT law. This proposal will increase voluntary compliance in current and future years, and will increase the revenues collected by way of the AMT/ISO provision.

IV. *Analysis of Proposal*

Proposal Aligns the Purposes Behind the AMT Tax Code and the Regular Tax Code

Argument A: Congress created the AMT system many decades ago to catch very wealthy individuals who were taking affirmative steps to avoid tax obligations, and Congress designed the regular ISO tax provisions to encourage and reward entrepreneurial activity. The AMT's imposition on the exercise of ISOs in prior years, most importantly years in which the stock market declines dramatically, not only undermines the purpose of the ISO tax provisions, it affirmatively punishes and discourages the taxpayers and the economic activity that Congress hoped to stimulate with the ISO provisions. Additionally, the people finding themselves caught in this AMT trap were not trying to avoid their taxes; they were simply enjoying the fruits of their labor and pursuing the incentives Congress created. Applying the AMT in the current manner is not serving the purposes of either legislation.

Argument B: Congress encourages insiders to hold on to acquired stock and build long-term value. Taxpayers who followed this good public policy should not face punitive taxes—up to and exceeding 100 percent of the value of the asset being taxed. The decline in the stock market from 1999–2002 is unprecedented—comparable only to the 1929 crash. President Bush and Congress have recognized the rarity of the circumstances by enacting a host of tax and business incentives designed to halt the market's decline and to help restore it to a normal level. Imposing the current AMT in this unique circumstance results in unintended and undue hardship, because these stockholders have already suffered the full decline of the value of the stock (as did all investors) but have been taxed as if the stock maintained its inflated value. Given the sharp decline in stock value, this tax is completely out of proportion with the value of the stock.

For example, if a taxpayer exercised ISOs for $10,000 and thereby acquired stock worth $100,000, the AMT would tax the $90,000 of economic income at roughly 28 percent, or $25,000. If the stock thereafter declined to $50,000, then although the economic gain decreased to $40,000, the AMT remains at $25,000, or roughly 63 percent of the economic income.

Argument C: This proposal aligns the purposes of the AMT and the regular tax code, by ensuring that (a) for purposes of the AMT, taxpayers prepay a fair tax on the deemed "value" of the stock arising from the exercise of ISOs, and (b) for purposes of the regular tax code, taxpayers who hold their stock for more than one year after exercising ISOs benefit from the capital gains rate that Congress intended. Congress did not intend taxpayers to be "caught in an AMT trap" because they followed the incentives of the regular tax code and obeyed the SEC insider trading laws. This proposal rectifies the unusual and severe disconnect that occurred between the AMT, the regular tax code, and the SEC Regulations in the unprecedented economic climate of 1999–2002, and can occur again at any time.

Under the example set forth above under *Argument B*, the regular tax code would tax the later sale of the acquired stock for $50,000 at 15 percent. Thus, the regular tax due would be $6,000 (15 percent of the $40,000 gain). Recall that the AMT attributable to the exercise was $25,000. Although the AMT rules provide for an AMT loss ($50,000 here) and an AMT Credit (equal to the amount of AMT paid), these losses or credits may take decades or centuries to be fully accounted for, as described more fully below.

Proposal is Revenue Neutral

This proposal is revenue-neutral from an accounting standpoint because the U.S. Government currently carries the taxpayers' AMT credits forward to future years. A short-term refund merely pulls forward the payment date of the intended credit to bring about a rational result, thereby increasing dollars invested in the economy, reducing bankruptcies, and increasing voter satisfaction. Additionally, this correction to the AMT does not increase Congressional tax expenditures, as defined by the Joint Committee on Taxation. In the Joint Committee's December 22, 2003 report, Estimates of Federal Tax Expenditures for Fiscal Years 2004–2008, prepared for the House Ways & Means Committee and the Senate Finance Committee, it was provided that: "The individual alternative minimum tax ("AMT") and the passive activity loss rules are not viewed by the Joint Committee staff as a part of normal income tax law. Instead, they are viewed as provisions that reduce the magnitude of the tax expenditures to which they apply. . . . Exceptions to the individual AMT and the passive loss rules are not classified as tax expenditures by the Joint Committee staff because the effects of the exceptions already are incorporated in the estimates of related tax expenditures."

The result of the current policy is that the taxpayers who made these prepayments have given the Government an interest-free loan; Sam Johnson highlighted this unfairness in his introduction to his Bill, H.R. 433, and a number of other Bills in recent Congresses have echoed that sentiment. Although the interplay of the AMT and regular tax code may result in situations in which a taxpayer would *not* receive the full credit back for the excessive prepayments *even after 10 years*, that result is so obviously inequitable that it is impossible to defend. The Government should consider whether it is proper for it to retain the excessive prepayments indefinitely.

Additionally, the Proposal *increases* revenue in an area of frequent and undetectable abuse by encouraging compliance with principled laws by previously discouraged taxpayers, and requiring compliance as to all taxpayers for current and future years. The result will be nearly 100% compliance as all taxpayers report and pay a fair tax on ISO/AMT gain. Additionally, our Proposal would generate even more revenue by encouraging taxpayers who have not reported (either through ignorance or perceived necessity) their ISO exercises to come forward and report them in the current taxable year.

Perhaps surprisingly, the timing of the gain calculation will also *increase* future revenues under this Proposal. The number of affected taxpayers will remain relatively constant as between the current ISO/AMT law and our Proposal; however, under our Proposal the valuation date is generally *one year after the exercise*, unlike the current law where valuation date is *the date of exercise*. Because the market traditionally increases year after year, the ISO/AMT tax will generally be imposed on stock with increased value, and the overall long-term effect of our Proposal will be to increase the revenue generated. Furthermore, where there are downturns in a particular stock or market, our Proposal automatically adjusts to avoid imposing punitive and excessive rates on persons who hold on to their stock. This Proposal thus generates increased future revenues by supporting the prepayment policies of the AMT, while also supporting the policy goals of the regular tax code of providing incentives for employees to invest in their companies and work for long-term growth rather than short-term profits.

Other considerations for purposes of scoring this Proposal include (i) current AMT/ISO liabilities may never be collected because the liabilities have exceeded yearly salaries, depleted assets, and caused bankruptcies and the losses of jobs; (ii) recent case law that has held that the IRS must consider whether a taxpayer's ISO/AMT liability should be reduced (thereby reducing revenues generated by current law) because the stock to which the liability attached was restricted stock and, hence, would be worth less than determined under the current ISO/AMT provision; and (iii) current enforcement expenditures (for audit, litigation, bankruptcy, offers in compromise, committees on effective tax administration, etc.) will be eliminated, resulting in substantial direct savings and in an indirect benefit from freeing up resources that can be used to enforce and collect from persons who owe taxes on *real* gain and who have *real* assets from which to pay the taxes owed.

Proposal Addresses the Unfairness of IRS Demanding Massive Interest-Free Loans

The irony in this situation is that many people are paying significant interest on loans from private creditors to prepay their interest-free loan to the Government. In some cases, the amounts at issue exceed hundreds of thousands, or even millions, of dollars. Additionally, the Government is increasing the burden by imposing interest and penalties on the taxpayers who haven't been able to pay all of their AMT because they simply lack the financial resources. Under the proposal, returning an excessive AMT prepayment is not a tax *rebate*, nor is it an unprincipled refund. The AMT credits were in fact intended to be returned to the taxpayers in a reasonable time, and to the extent the quirks in the AMT code undermine this repayment intent and extend the "repayment period" out to tens and hundreds of years—the AMT code needs to be fixed.

V. *Administrative Policy Support for Proposal*

Proposal Furthers Good Corporate Governance

One of the only legitimate ways that a taxpayer currently can avoid the AMT application to ISOs is to sell the stock during the same tax year that he or she acquired it. Unfortunately though, many people who acquired stock through the use of ISOs also fall under insider trading laws and policies and must rebut a presumption of insider trading. Meeting that burden of proof can be very difficult because it requires the defendant to prove that he or she did not have any inside information. It is fairly difficult, if not impossible, to determine with foresight any period during which these individuals could sell stock without facing possible allegations of insider trading, especially when the stock subsequently declines in value; in 1999–2002, that problem was exacerbated through dramatic market declines. Moreover, corporate insiders likely are in a better position than shareholders to know that the stock may be overvalued in a declining market, and selling the stock merely shifts the losses to potentially unsuspecting buyers. The Government is focused on strong corporate governance practices, and should not require its citizens to choose between complying with tax laws or securities laws.

Proposal Protects Public Shareholders

Taxpayers who held on to their stock over these years followed the incentive structure for ISOs and fully complied with applicable SEC restrictions. If these individuals had sold their stock to the public, the new and existing stockholders would have borne the significant decline in the stock value. The public has been outraged at insiders who "dump" their stock at its peak value, and who make off with millions while the public shareholders suffer the dramatic decline in value. Additionally, the public has filed civil suits against the companies and the individuals, and the SEC has pursued legal action against possible insider trading violations. Due to the activities during the 1999–2002 trading years, these actions have only increased in frequency. Clearly, the better public policy decision is to repair laws that, due to unusual circumstances, are punishing company insiders and other employees for holding stock and bearing potential losses personally, rather than foisting losses on the public. Without this repair, these employee-shareholders are literally in a no-win situation where the laws are punishing them no matter the course they take.

Proposal Encourages Voluntary Compliance with Tax Laws

The AMT tax system relies on honest individuals to report their ISO transactions, without any built-in checks to determine who has exercised ISOs. Currently, no relevant information is shared between the companies, the IRS, and the SEC or brokerage houses. In 1999–2002, the taxpayer who exercised ISOs was faced with the Hobson's choice of either (a) facing financial ruin for reporting honestly and including AMT calculations for ISO exercises, thereby paying punitive taxes imposed on phantom income at an arbitrary 26 or 28 percent tax rate, which in a falling market may exceed significantly the value of the underlying stock, or (b) illegally reporting only under the regular tax system.

The Government should examine whether taxpayers who follow the law should be punished with an unintended tax that may approximate or exceed 100 percent of the value of the asset taxed, while taxpayers who simply ignore the law avoid paying the tax and may never be caught. This proposal institutes corporate reporting of ISO exercises, with no additional burden on the corporations. This reporting requirement, combined with the fairer provisions of this proposal, encourage voluntary compliance and generate increased collection of revenues with minimal enforcement efforts.

Proposal Aligns the AMT Tax Rate with Current Tax and Business Policy

The Government has passed laws lowering the long-term capital gains rate to 15 percent to encourage investment and commitment to a company's long-term success. It undermines that policy's purpose to subject people who have already lost the value of their stock to a 26 or 28 percent prepayment tax rate on the phantom economic income computed on the date of exercise. This is especially true when the actual tax rate on that stock at a later sale is 15 percent of the actual gain. Worse yet, if the company dissolved, as many did, the underlying stock is worthless and the prepayment amounts under the AMT will be, in all practicality, unusable AMT credits.

For instance, the Speltz family in Iowa has annual income of roughly $80,000, and had annual tax liability of less than $20,000. In 2000, their exercise of ISOs generated a federal tax bill in excess of $260,000 and an AMT Credit of approximately $240,000, despite having received no money. To add insult to injury, their AMT Credit will only serve to reduce their regular taxes to the extent the regular taxes exceed that which would be due under the AMT system. In the best-case scenario, assuming the Speltzes have recurring regular tax liability of $20,000, and would owe $0 under the AMT system, it would take approximately 20 years for the Speltzes to fully recover the AMT Credit of $240,000. Note that this "timing issue" has required the Speltzes to effectively liquidate all of their assets to make what prepayments they can. Additionally, they will be forced to file for bankruptcy this year because they cannot pay the nearly $140,000 in federal taxes (plus interest and penalties, computed as of October 2003) they "owe" under the AMT, *in spite of the fact that they are hard-working productive citizens who have currently already* ***overpaid*** *more than $100,000 in federal AMT taxes!*

The Government should consider whether taxpayers who made significant personal sacrifices and behaved in a manner demonstrating their commitment to their company's long-term growth and the economy as a whole, should be subject to a 26 or 28 percent tax on income they have not yet, and may never, receive. The Government should further consider whether those who "prepaid" taxes at a 26 or 28 percent rate on the unrealized income, and who will be entitled to the 15 percent capital gains rate on their *actual* gain (if any), should be reimbursed for their overpayment in a timelier manner than what is possible under the current system.

VI. *Conclusion*

Congress must act now to rectify the AMT's most dangerous and harmful provision, the ISO rule. Without a change, the current application of the AMT/ISO provision will continue to cause unintended, egregious, and devastating tax burdens, and hobble the very entrepreneurial drive that made small business a powerful engine of the U.S. economy. The proposal addressed herein would make the AMT/ISO rule less complex and more fair for all involved, and would allow the Congressional purpose of the AMT to remain intact while providing a simple, principled, and equitable solution to taxpayers.

This proposal's overarching goal is to maintain the AMT as a separate tax system and to tax (so-called) economic wealth on a current basis. It also reflects Congress's intent regarding the purpose and prevalence of ISOs in today's marketplace. By synchronizing the disconnects between the regular tax and the AMT treatments of ISOs, this proposal preserves the AMT's aims while helping entrepreneurs return to a position of bolstering this nation's economy. We urge you to sponsor and publicize your support of this proposal, for the good of the economy and to give taxpayers the fair treatment they deserve.

Statement of the Honorable Scott Garrett, a Representative in Congress from the State of New Jersey

Municipal Lease Financing—Why it is Good Policy

In times of economic hardship and decreased federal funding municipalities have had to become creative in finding ways to stretch their limited resources. Critical infrastructure projects and services such as mass transit and water and sewer systems must be built, maintained and improved all while trying to avoid implementing costly tax increases as well as fare or rate hikes. My district, like many of yours, has benefited from municipal lease financing in order to fund important projects and bypass putting an extra financial burden on our constituents. Extreme financial pressure and difficulty in finding alternative funding sources are a reality, but municipal lease financing has allowed public entities to improve their assets and provide us with the services that our daily lives have come to depend on.

Over the past eight years, assets with a total value of approximately $22 billion have been financed through tax-exempt leasing. These lease transactions are based upon well-organized legal principals that have been developed over many years and are structured in compliance with current and longstanding provisions of federal law and regulations. Each transaction is reported in pursuant to well established tax laws and disclosed in compliance with IRS registration rules. Most importantly, all leases generate positive tax income over the lives of the transactions and set up neither permanent tax deferral nor tax avoidance.

Many municipal leasing transactions are structured as sale-leasebacks in accordance with the same leasing principals extensively used by the private sector. The municipalities convey ownership interests in assets to private investors for a sale price equal to the fair market value and then lease the asset back. Private entities are interested in entering into such deals because they generate earnings on their investment and facilitate the acquisition of equipment. Municipalities in return receive an up front cash benefit and an important tool to help make ends meet.

I urge you to preserve the ability of municipalities and other domestic tax-exempt entities to enter into these lease transactions. As we work towards economic recovery it is crucial that we allow our cities and states a means to augment their financial resources. We must continue to foster these public/private sponsorships and do all that is in our power to help provide the services our constituents require.

Statement of the Honorable Mark Green, a Representative in Congress from the State of Wisconsin

Thank you, Mr. Chairman, for the opportunity to testify before the Select Revenue Measures Subcommittee on the need for the Former Insurance Agents Tax Equity Act which provides a legislative fix to a small, but important retirement tax problem that some of my constituents now face.

Under current law, a small number of agents are forced to pay self-employment taxes on their retirement payments, while their peers at other insurance companies do not. This is because a change in the Taxpayers Relief Act of 1997 (TRA) was drafted in a way that unintentionally excluded this small group.

In the TRA, Congress included a provision intended to clarify that certain termination payments received by valued, long-term former insurance agents should be exempt from self-employment (SECA) tax. Unfortunately, the changes in 1997 provided clarification for most agents, but not others, depending on how insurance companies structure their agent agreements.

As enacted, the 1997 provision provides that payments to a retired agent are exempt from self-employment tax when the agent's eligibility is tied to length of service, but not when the actual amounts of the payments are tied to the agent's length of service. Simply put, this is a distinction without a difference. There is no reason to provide different tax treatment for arrangements that are so similar just because the sum of an agent's termination payment is determined by varying the amount of compensation rather than the term of compensation.

Hard-working agents whose payments are tied to their length of service deserve the same fair treatment accorded to their counterparts at other insurance companies. Both types of contract seek to satisfy the same goal of rewarding loyal, long-time agents with more generous retirement payments. (All of these payments, of course, continue to be subjected to income taxes.)

I am pleased to note that my colleague from Wisconsin, Congressman Paul Ryan (R–WI), has introduced the Former Insurance Agents Tax Equity Act (H.R. 1250) to correct this problem. This legislation would simply strike language in the Internal Revenue Code that prevents companies from using a former agent's length of service in determining the amount of termination payment the agent will receive. In doing so, this bill fulfills Congress' intentions with the TRA and provides equitable tax treatment for all former agents. Congressman Ryan's legislation has solid bipartisan support among many members, including several members of the Ways and Means Committee, and there is no opposition to it. I also note that it enjoys the support of many insurance agents—not just in Wisconsin, but throughout the country, as well as the National Association of Life Underwriters, the Coalition of Exclusive Agents, and the National Association of Independent Insurers. In addition, the budget implications are minor since only a very small number of agents are affected.

I hope my colleagues will join me in supporting the Former Insurance Agents Tax Equity Act that will ensure that termination payments to retired insurance agents are treated equitably under our tax laws.

Thank you again, Mr. Chairman, for allowing me to testify on this issue.

Statement of the Honorable Michael Honda, a Representative in Congress from the State of California

Mr. Chairman and Ranking Member McNulty, I thank you for this opportunity to share my concerns about the treatment of Incentive Stock Options under the U.S. tax code and to urge your Subcommittee to take timely legislative action to rescue thousands of Americans from financial ruin.

For the last five years, the Alternative Minimum Tax's Incentive Stock Option rule has had an unintended devastating effect on hard-working, honest taxpayers. This little known provision of the AMT assesses tax liabilities on private sector employees who exercise stock options, even when no gains have been realized. Congress certainly never intended for taxpayers to be liable for tens or hundreds of thousands of dollars on stock that became virtually worthless.

The AMT was designed to ensure that wealthy Americans could not avoid taxes through excessive use of tax preferences, but in this case, the AMT's Incentive Stock Option rule is most injurious to average Americans hoping to secure a strong financial future for them and their families.

The taxpayers affected by the ISO provision are desperately in need of help. Many of them have been subjected to tax rates in excess of 300% of their annual income. Unable to pay, these Americans are at the mercy of the Internal Revenue Service, which has chosen to move these cases into collection status. As a result, wages have been garnished, retirement accounts seized, and the vehicles and homes forcibly sold. These measures are extreme and undeserving.

For too long Congress has neglected this incredibly important issue, and I appeal to my colleagues on this Subcommittee to pursue a legislative and regulatory remedy to this injustice before more taxpayers are financially harmed.

LEGISLATIVE REMEDY

The Congress must pass legislation to correct the AMT ISO provision. Our colleague, Zoe Lofgren, recently introduced H.R. 5141, legislation that will repeal the AMT treatment of incentive stock options, shifting the taxable event from the exercise of the stock option to the sale of stock. This same legislation was introduced during the 107th Congress, which adjourned without taking action on the bill. I was an original cosponsor of this bill, and I wholeheartedly support Rep. Lofgren's decision to reintroduce the bill. I hope the Subcommittee will give her proposal the consideration it deserves.

I am also intrigued by a proposal now in development by Rep. Sam Johnson. Following the advice of four former Internal Revenue Service commissioners, Rep. Johnson has crafted legislation that may comprehensively remedy the complexity and inequity of the current ISO AMT system, for taxpayers, Congress, and the IRS. This new proposal includes measures to restore Congressional incentives that encourage workers to invest in their companies and retain that stock until it becomes a long-term capital asset. In addition, it addresses the AMT prepayment provision in such a way that it does not trap taxpayers during economic downturns, and it fairly resolves the current harm done to honest, hardworking Americans by the current AMT ISO rule.

REGULATORY REMEDY

Congress has provided the IRS flexibility in the resolution of tax code infractions, and the IRS must employ this flexibility to hold harmless those unduly harmed by the AMT ISO rule. More specifically, the IRS should consider greater use of Offers in Compromise (OIC). Proper application of these provisions would give some measure of relief to the most pressing cases.

AMT ISO liabilities were the subject of a Ways & Means Oversight Subcommittee hearing on June 15 of this year. At that hearing, taxpayer Nina Doherty addressed the IRS's aggressive enforcement and refusal to consider Offers in Compromise with respect to this issue, despite the power afforded it by statute and its own regulations. The IRS's categorical denial of Offers in Compromise ignores its own standards of special circumstances, hardship, public policy, and the promotion of effective tax administration, and ignores the advice and pleading of numerous practitioners, professors, the National Taxpayer Advocate, and Congress. The OIC program is already in place, and if properly applied by the IRS, can help those taxpayers suffering under this severe burden. Although the OIC is merely a stop-gap remedy, I encourage this Select Revenue Measures Subcommittee to utilize its influence to urge the IRS to take appropriate remedial action.

Multiple coalitions of individuals and of companies have been formed to follow, address, and resolve this single issue, aided by the print and screen media. Unfortunately, although we've worked on this issue for years, the problem hasn't been solved for a single suffering taxpayer. I urge this Subcommittee, and the rest of Congress, to join in resolving this issue.

Thank you for this opportunity to testify on the importance of restoring fairness in the U.S. tax code.

Statement of the Honorable James R. Langevin, a Representative in Congress from the State of Rhode Island

A Tax Incentive For Life Safety

Fire Sprinkler Incentive Act of 2003

Ad Hoc Committee Members

American Fire Sprinkler Association
Campus Firewatch
Congressional Fire Services Institute
International Association of Arson Investigators
International Association of Fire Chiefs
International Fire Service Training Association
National Fire Protection Association
National Fire Sprinkler Association
National Volunteer Fire Council

April 18, 2003

> America Burning Recommissioned, *America at Risk: Findings and Recommendations on the Role of the Fire Service in the Prevention and Control of Risks in America*, December 2000
>
> The frequency and severity of fires in America do not result from a lack of knowledge of the causes, means of prevention or methods of suppression. We have a fire "problem" because our nation has failed to adequately apply and fund known loss reduction strategies. Had past recommendations of America Burning and subsequent reports been implemented there would have been no need for this Commission. Unless those recommendations and the ones that follow are funded and implemented, the Commission's efforts will have been an exercise in futility. The primary responsibility for fire prevention and suppression and action with respect to other hazards dealt with by the fire services properly rests with the states and local governments. Nevertheless, a substantial role exists for the federal government in funding and technical support.

The Problem

The 2000 *America Burning—Recommissioned* report is an update of the landmark study conducted originally in 1974. Sadly, as we have seen once again in the past few months, not enough has been done to advance the level of fire safety in the country's built environment. The recent tragedies that have struck in West Warwick, Rhode Island and Hartford, Connecticut only serve to underscore the fact that we have been incredibly remiss in putting into action the technology and knowledge that we have gathered over the past century.

Fires are tragedies that are avoidable. The consequences that we see, the loss of life, the extensive property damage **does not have to happen**.

The latest data available reports that:

- Fire departments responded to 1.7 million fires in 2001.
- There were a total of 521,000 structure fires.
- There were 3,745 fire deaths in the United States in 2001 (not including those lost on 9/11).
- Fires caused almost 21,000 civilian injuries.
- Excluding the events of 9/11, 99 firefighters were killed in 2001.
- Fire caused $8.9 billion in direct property damage.

This translates to the fact that a fire department responds to a fire every 18 seconds in the United States. Every 60 seconds a fire breaks out in a structure, and in a residential structure every 80 seconds.

When evaluating the fire problem in the United States, it is important to look at where the fires are occurring as well as recognize major fire death potential so that a viable strategy can be developed to address the problem.

Currently there are a number of programs in place that are aggressively addressing the fire problem through engineering, technical assistance and public education. However, even in this environment, the major hurdle to be overcome to reach the next step of fire safety is that of economics, or specifically the direct cost of installing fire sprinkler systems. All too often when making decisions on adopting aggressive fire safety codes, it is only these direct costs that are discussed with little consideration to the indirect costs of fire.

The historically significant fires that have occurred in our nation, especially the large loss of life fires, have occurred in a variety of occupancy usages. Across the board, fires present a problem in different occupancies, ranging from low-rise residential occupancies to commercial nightclubs to high-rise structures.

There are a number of different factors that go into making a fire-safe structure. These factors are outline in the fire and building codes that are in use across the country. However, as we have seen by recent fire tragedies, these are by no means a guarantee that an existing building will meet the level of fire safety established in the codes.

The Solution

> *The NFPA has no record of a fire killing more than two people in a completely sprinklered public assembly, educational, institutional or residential building where the system was properly operating.*

As stated above, there are several strategies that can be adopted to address the fire problem. However, one clearly stands above the others in terms of its immediate impact upon life safety and property conservation: automatic fire sprinkler systems. Sprinklers can reduce your chances of dying in a fire from one-half to two-thirds as reflected in the information below.

Civilian Deaths per Thousand (NFPA)

(National estimates based on 1988–1998 NFIRS and NFPA survey)

Property Use	**Without Sprinklers**	**With Sprinklers**	**% Reduction**
Public Assembly	0.8	0.0*	100%
Health Care	4.9	1.2	75%
Apartments	8.2	1.6	81%
Hotels and motels	9.1	0.8*	91%
Dormitories and barracks	1.5	0.0*	100%
Industrial	1.1	0.0*	100%
Manufacturing	2.0	0.8	60%
Storage	1.0	0.0*	100%

*Based on fewer than two deaths per year in the entire ten-year period. Results may not be significant.

In addition to being an invaluable life-safety tool, sprinklers are unparalleled in reducing the property loss. As seen in the following table, the property loss from fires over a ten-year period shows a significant reduction ranging from a low of 42% to an impressive high of 70% in public assembly occupancies.

Estimated Reduction in Property Damage per Fire (NFPA)

(National estimates based on 1989–1998 NFIRS and NFPA survey)

Property Use	Without Sprinklers	With Sprinklers	% Reduction
Public assembly	$21,600	$6,500	70%
Educational	$13,900	$4,400	68%
Residential	$9,400	$5,400	42%
Stores and offices	$24,000	$12,200	50%
Industrial	$30,100	$17,200	43%
Manufacturing	$50,200	$16,700	67%

No one can argue against the effectiveness of sprinklers in controlling a fire and saving lives and property. The major impediment to their widespread use has simply been an economic one.

Sprinklers can be installed in almost any occupancy today. High-rise buildings, assisted living facilities, warehouses, assembly, even residential condominiums and homes—all of these occupancies will benefit greatly from the existence of an automatic fire sprinkler system.

In terms of life safety, buildings such as high-rise residential and commercial buildings, dormitories, Greek housing, assisted living and nursing homes are among those that will have the most direct benefit from a sprinkler system. Other buildings, such as industrial or manufacturing facilities often already have sprinkler systems installed as part of their requirements for obtaining insurance. If not, however, by installing a sprinkler system they are providing a significantly higher level of protection to their property, ensuring continued business operation and continued employment. This translates into a stronger workforce for the community as well as a viable tax base.

While a tax incentive may appear to be singularly a negative cash flow to government, it is in fact an economic stimulus. Quite frankly, fire sprinkler retrofit is not widespread because of the direct costs. With our current low interest rates, coupled with this tax incentive, fire sprinkler retrofit will become attractive and as a result revenue will be generated through increased production of products and services. Fire sprinkler retrofit is very labor intensive with the average percentage of labor costs for retrofit projects estimated at 65%. The benefits of increased employment together with the increase production of materials to meet this new market must also be considered as an economic stimulus.

The installation of sprinklers not only protects the occupants of these buildings, it also provides life safety to the responding fire fighters. A sprinkler system will control a fire, if not extinguish it, in its earliest stages. This reduces the risk to the occupants and to the fire fighters. This is even more critical in a high-rise building where fighting any fire is an extreme challenge.

Sprinkler systems can dramatically improve the chances of survival of those who cannot save themselves in a timely manner, specifically older adults, younger children and those with disabilities.

Fiscal Impact

In the present economy, providing some mechanism and incentive for building owners to install critical life-saving systems such as automatic fire sprinklers is paramount. The question is how to best accomplish this?

Due to financial burdens many nightclub and high-rise building owners are reluctant to upgrade fire safety within their structure unless forced to do so by government. State and local governments recognize the financial burden that these improvements may impose and therefore have been reluctant to force changes to modern code requirements. Failure to upgrade has additional financial burdens as evidenced by the indirect costs of a fire that the community has to endure, such as increased workers' compensation for fire fighter injuries, lost revenue for destroyed businesses, increased litigation costs imposed on government, indirect loss of revenue from a decline in tourism when the fire occurs in a tourist driven economy, the list of indirect cost of fire is very long.

A viable and reasonable solution is the use of a tax incentive. The use of tax incentives to stimulate the economy has been well documented in our country. Taxes have a major impact on a business's cash flow and in many cases taxes may determine a company's viability and survivability. For many property owners the ability to capture and recover expenses in the tax system is critical for economic survival, particularly when local government mandates fire sprinkler retrofit to protect its community's infrastructure and economic base.

Currently, when installing a sprinkler system in any building, be it a high-rise building housing elderly citizens or a place of assembly, the cost of the system is expensed over its depreciable life. Currently, for a commercial occupancy this would represent 39 years, for a residential occupancy such as a high-rise apartment building, this would be 27.5 years. This actually provides a disincentive to install a system because of the long payback that can be realized for the investment.

In 1986 Congress approved the Modified Accelerated Cost Recovery System (MACRS) that provides a reasonable alternative to the current straight-line depreciation method that is used.

Under the MACRS method of depreciation, several classes of assets with prescribed recovery periods or class lives are defined. The major effect of the MACRS system is to shorten the depreciable lives of assets, thus giving businesses larger tax deductions. This in turn increases their cash flow for reinvestment.

We are proposing the use of the MACRS system with the Five-Year class life be used for the installation of an automatic fire sprinkler system in any occupancy. This will provide a strong incentive to install these systems into a variety of occupancies, but especially into those where lives are at greatest risk, such as nursing homes, places of assembly and high-rise residential and commercial buildings.

5 deadliest U.S. nightclub fires of the last 50 years

•Beverly Hills Supper Club, Southgate, KY, May 28, 1977, 165 killed.

•The Station nightclub, West Warwick, RI, February 20, 2003, 99 killed.

•Happy Land social club, New York, NY, March 25, 1990, 87 killed.

•Upstairs Lounge, New Orleans, LA, June 24, 1973, 32 killed. Second-story cocktail lounge.

The moral justification for the installation of sprinkler systems in these buildings has been demonstrated for many years. National fire codes have called for the installation of sprinklers in any new and existing buildings, particularly high-rise buildings, for many years. Following a series of horrific nursing home fires in the 1970s, most nursing homes across the country were equipped with sprinklers.

Preliminary estimates suggest the cost to install the life saving fire sprinkler system in The Station in West Warwick would have been under $20,000. The average cost of retrofitting a fire sprinkler system in an existing high-rise can range from approximately $2.00 per square foot to a high of $3.00 per square foot, depending upon the area of the country. And the decisive factor in determining where within the price range a specific project will fall is that of labor costs. The cost of labor varies throughout our country and as previously stated that an average of 65% of the costs of fire sprinkler retrofit comes from labor costs.

Depreciation Schedule Example

The following example is for the installation of two automatic fire sprinkler systems should they be installed today; one that costs $100,000 and another that costs $250,000. The $100,000 example is for a residential apartment building that would fall under the 27.5-year depreciation schedule while the $250,000 example is a commercial high-rise building that would use the 39-year depreciation schedule. It is assumed that the systems are placed into service in the middle of the first year, therefore the effect of this half-year convention is to extend the recovery period for an additional year, resulting in the six-year depreciation schedule shown below. In addition, the deduction scenario for a $20,000 sprinkler system installed in The Station nightclub in West Warwick, typical of many of the occupancies targeted by this tax incentive, is also included.

MACRS Five-Year Class Life

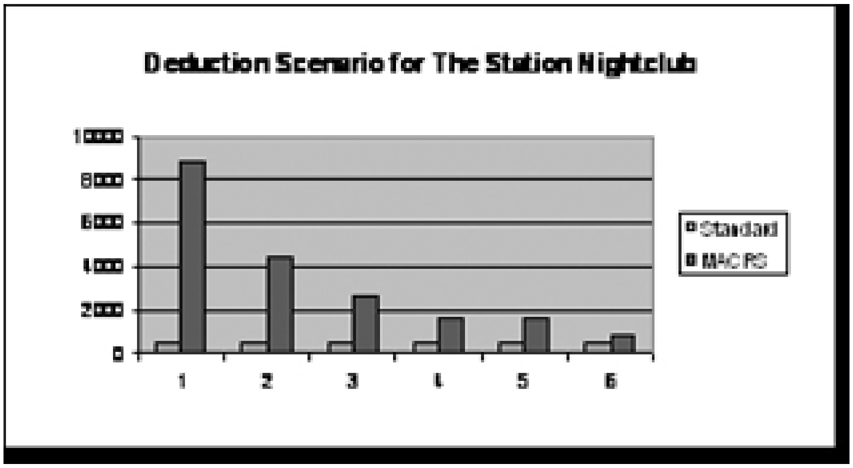
Year	The Station—$20,000 Installation		$100,000 Installation Residential Apartment		$250,000 Installation Commercial High-rise	
	Current 39-year Depreciation Schedule	MACRS Depreciation Schedule	Current 27.5-year Depreciation Schedule	MACRS Depreciation Schedule	Current 39-year Depreciation Schedule	MACRS Depreciation Schedule
1	$256.50 [a]	$8,800	$1,667 [a]	$44,000 [b]	$3,205 [a]	$110,000
2	$513	$4,480	$3,636	$22,400	$6,410	$56,000
3	$513	$2,688	$3,636	$13,440	$6,410	$33,600
4	$513	$1,614	$3,636	$8,070	$6,410	$20,175
5	$513	$1,612	$3,636	$8,060	$6,410	$20,150
6	$513 [c]	$806	$3,636 [c]	$4,030	$6,410 [c]	$10,075

a. First year depreciation using the ½-year convention.

b. This figure is arrived at by the 30% bonus for the first year, $100,000 × 30% = $30,000. The remaining $70,000 is depreciated using the double declining balance method (0.40 × $70,000 = $28,000) then applying the ½-year convention ($28,000/2 = $14,000). Therefore, the first year bonus plus the ½ year convention is $30,000 + $14,000 = $44,000. Subsequent years are based on a standard 5-year deduction schedule.

c. This dollar value is continued for the remaining length of the depreciation schedule, 27.5 years or 39 years.

Consistent with tax incentive actions provided in the *Job Creation and Workers Assistance Act of 2002* passed by Congress, an additional 30% deduction is figured into this tax incentive. The first year's depreciation is deducted on the balance after the special depreciation allowance of 30% is applied, again a procedure consistent with the established provisions applied in the *Job Creation and Workers Assistance Act of 2002*.



If a $20,000 sprinkler system had been installed in The Station nightclub in West Warwick, the total deductions in the first six years, under the current 39-year schedule, would have amounted to $2,822. Under the MACRS scenario, the system would have been fully deducted within six years.

Conclusion

The year 2003 has been a terrible one for fire tragedies. People die every day in horrific fires that can be avoided. The tragic event at The Station nightclub where 99 people died in West Warwick, Rhode Island, reminds us that we have to make a change, here and now. We know what the answers are and have known for many years. It is time for us to put these solutions in place so that we are never destined to repeat the tragedies of West Warwick, Hartford, New York, Southgate and the other fires that have killed so many.

> ***By promoting the installation of automatic fire sprinkler systems in these occupancies, it is our collective belief that the Federal government will have the opportunity to take a significant, proactive step in safeguarding the lives of our citizens.***

The solution proposed in this paper is one that can be applied across our nation, no matter how large or small a community may be. Residential and commercial high-rise, dormitories, Greek housing, privately owned student housing, public assembly—these are occupancies that can be found in almost any community. Our older adults, young children and people with disabilities, or those who statistically are our higher fire risk groups can be found in all of these buildings.

By passing a tax incentive, Congress can have a critical role in making the places that our citizens live, work and play dramatically safer. This will avoid our repeating a tragic history that has been seen all too often over the years. This will also serve to protect our vital community infrastructure in these uncertain times. And this tax incentive will also act as an economic stimulus.

Quite simply, the time is now.

National Association of Bond Lawyers
Washington, DC 20005
October 8, 2004

Honorable Jim McCrery
Chairman
Subcommittee on Select Revenue Measures
1135 Longworth House Office Building
Washington, DC 20515

I am writing on behalf of the National Association of Bond Lawyers ("NABL") to offer the accompanying proposals for the simplification of federal tax law as it pertains to tax-exempt bonds. These proposals are grouped in two parts: Part I describes proposals related to governmental purpose bonds; Part II offers suggestions related to qualified private activity bonds and other tax-exempt bond matters. We are pleased that the Public Finance Network has commended our simplification proposals in their submission to the Subcommittee. Several of NABL's proposals in Part I pertaining to governmental bonds would implement the reforms the PFN advocates. We look forward to working closely with the PFN on these issues in the future.

NABL is a nonprofit corporation organized for the purpose of educating its members and others in the law relating to state and municipal bonds, providing a forum for the exchange of ideas as to law and practice, improving the state of the art in the field, providing advice and comment at the federal, state and local levels with respect to legislation, regulations, rulings and other actions, or proposals therefore, affecting state and municipal obligations, and providing advice and comment with regard to state and municipal obligations in proceedings before courts and administrative bodies through briefs and memoranda as a friend of the court or agency. NABL currently has approximately 3,000 members.

We would of course be more than happy to discuss any or all of these proposals further with you and your Subcommittee colleagues, and the staff of your Subcommittee, and to provide additional materials, including drafts of legislative language to implement these proposals, should you wish to have them. Please do not hesitate to contact me if you feel NABL and its members can provide you with additional assistance.

Sincerely,

Monty G. Humble
President

NATIONAL ASSOCIATION OF BOND LAWYERS

TAX SIMPLIFICATION PROPOSALS RELATING TO TAX–EXEMPT BONDS

I. *Simplification Proposals Relating to Governmental Purpose Bonds*

1. Permit One Additional Advance Refunding of Governmental Bonds and Qualified 501(c)(3) Bonds

Present law. In general, issuers of tax-exempt governmental bonds (i.e., excluding most private activity bonds) and qualified 501(c)(3) bonds are provided one advance refunding opportunity for tax-exempt bond issues issued after December 31, 1985. Here, an "advance refunding" means an issuance of refunding bonds to refund other bonds ("refunded bonds") where the refunding bonds are issued more than 90 days before the redemption of the refunded bonds.

Example. Assume a local government issued tax-exempt bonds in 1994 to finance the construction of a new school building. The bonds contain a 10-year no-call period which is standard in the municipal market. In 1999, with the decline of interest rates, the issuer decided to advance refund its bonds to achieve net interest cost savings. Under current law, the issuer is permitted only one advance refunding. Therefore, when interest rates dropped to historic lows in 2003 and 2004, this issuer would be prevented from doing an additional advance refunding to achieve further net interest cost savings.

Reason for Change. For State and local governmental issuers and Section 501(c)(3) exempt organizations, debt service represents one of the most significant elements of their operating expenses. These governmental and nonprofit entities must manage the burden of paying debt service on bonds that have been issued to finance significant capital investments, such as roads, schools, hospitals, universities, transit systems, and other types of infrastructure.

When possible, issuers may elect to refinance their debt to take advantage of lower interest rates, thereby lowering their cost of borrowing. In addition, issuers may desire to refinance their outstanding debt to restructure the timing of debt service payments to better coincide with available revenue flows, take advantage of more modern financing techniques or to incorporate more flexible financial and legal covenants.

Because State and local governments and Section 501(c)(3) exempt organizations generally have only one opportunity to advance refund their debt (for new money bonds issued after December 31, 1985), they are put in the inflexible position of having essentially to guess when would be the optimum time to do that advance refunding to achieve the lowest net borrowing costs. The declining interest rate environment over the past few years had provided clear circumstances in which the one advance refunding restriction might have caused State and local governments and Section 501(c)(3) nonprofit organization potentially to miss out on opportunities to lower their borrowing costs. As described in the example above, an issuer that chose to advance refund its debt in 1999 would be prevented from advance refunding the same debt in 2003 or 2004 for further interest cost savings simply because it "guessed" wrong in 1999.

Congress should amend Federal tax law requirements to permit State and local governments and Section 501(c)(3) nonprofit organizations one additional advance refunding opportunity for their tax-exempt bonds.

2. Provide a Streamlined 3-Year Spending Exception to the Arbitrage Rebate Requirement in Lieu of the Present 2-Year Construction Spending Exception

Present law. Generally, interest earnings on investments of tax-exempt bond proceeds in excess of the bond yield must be rebated to the Federal Government. The main existing spending exception to arbitrage rebate is a complex 2-year spending exception applicable only to governmental and qualified 501(c)(3) bonds issued to finance certain construction projects.

Example. Assume bonds are issued by a local government to construct a courthouse. The issuer plans to use the 2-year rebate spending exception and has sized the issue to meet the spending benchmarks, including expenditure of all investment earnings. The issuer meets the first two semiannual spending benchmarks, but unusual inclement weather causes the issuer to fall short of the third benchmark. Under current law, the issuer looses the total benefit of the rebate exception and must rebate any excess investment earnings over the yield on the tax-exempt bonds to the Federal Government, even though the issuer had sized the issue to spend all earnings on the project.

Alternatively, to further illustrate some of the conditions to the existing exception, suppose an issuer who infrequently came to market planned for efficiency purposes to do a single tax-exempt bond issue to finance several major capital projects with a total expected spending period of 2½ years. Suppose further that the issuer expected to use about one-third of the bond proceeds to finance various land acquisitions and equipment purchases associated with these capital projects. Here, both the 2½ year spending period and the use of more than 25% of the bond proceeds on expenditures which were not technically "construction" expenditures would make this bond issue ineligible for the 2-year rebate spending exception.

Reason for Change. The present 2-year rebate spending exception provides for unrealistic spending periods, complex bifurcation procedures, difficult and repetitive computations, and unclear multipart definitions. The exception should be modified to be simple in its application and to permit issuers and conduit borrowers three years (rather than two years) years to meet the applicable spending requirements. In addition, this exception should be expanded to include both private activity bonds and governmental bonds, as well as to include bonds for any capital project (encompassing both acquisition and construction purposes). Also, the election to pay a penalty in lieu of rebate is rarely used and should be eliminated. This streamlined 3-year rebate spending exception should apply as broadly as possible, particularly given that limited arbitrage potential exists for short-term investments in most in long-term tax-exempt bond issues. This 3-year rebate spending period would provide meaningful administrative relief from complex arbitrage calculations to a broad number of tax-exempt bond issuers. The proposed spending benchmarks should contain a de minimis exception to broaden the availability of the exception to cover many circumstances in which minor amounts of bond proceeds remain unspent for bona fide reasons. This spending exception should be limited to fixed rate tax-exempt bonds to recognize one area in which some arbitrage potential may exist under a 3-year spending period in normal yield curves, which involves tax-exempt floating rate bonds with short-term tender options. The new 3-year spending exception also should exclude bonds issued mainly for working capital and refundings.

3. Increase the Small Issuer Exception to the Arbitrage Rebate Requirement from $5 Million to $25 Million and Remove the General Taxing Power Condition

Present law. Generally, interest earnings on investments of tax-exempt bond proceeds above the yield on the tax-exempt bonds must be rebated to the Federal Government. Under the small issuer exception, the rebate requirement does not apply to governmental units with general taxing powers where the amount of bonds issued by the unit in the calendar year is not reasonably expected to exceed $5 million (excluding private activity bonds and most current refunding bonds with a principal amount not exceeding the principal amount of the refunded bonds).

Example. If an issuer with general taxing powers issues bonds to construct a library, and if the principal amount of bonds is $5 million or less (taking into account other bonds issued by the issuer in the calendar year), then the rebate requirement does not apply to the bonds. If, however, the principal amount of bonds is $5.1 million, or if the issuer does not have general taxing powers, such as a public building authority which is an instrumentality of a governmental unit with general taxing powers, then the rebate requirement applies to the bonds.

Reason for Change. With one exception, the small issuer exception to the rebate requirement has remained at $5 million since its inception in 1986. Thus, while all other costs associated with capital expenditures (construction, acquisition, administrative, etc.) have increased, the $5 million limitation has remained stagnant.

Increasing the small issuer exception will substantially reduce the administrative burden imposed on a large number of small issuers by the rebate requirement while affecting a disproportionately smaller amount of tax-exempt bond dollar volume. As an illustration of this disproportionate effect involving larger numbers of small affected bond issuers and smaller amounts of affected bond dollar volume, in 2003, tax-exempt issuers of $10 million or less of bank purchase qualified bonds issued 4,700 bond issues out of 14,833 total tax-exempt bond issues, representing 32% of the total number of such bond issues. The dollar volume of those bond issues, however, was only about $15.25 billion out of about $382.7 billion of total tax-exempt bond dollar volume, representing only about 4% of tax-exempt bond dollar volume. At the example $10 million level, the difference between the large number of small bond issuers who could be relieved of administrative burdens (32%) and the smaller affected tax-exempt bond dollar volume (4%) is compelling.

Moreover, if an issuer is a governmental unit authorized to issue bonds, it should be eligible for the small issuer exception to the rebate requirement even if it does not have general taxing powers. The requirement for the existence of general taxing powers unfairly narrows the benefit of the exception. State or local governments commonly use public instrumentalities without general taxing powers to carry out tax-exempt bond programs.

4. Add An Exception to the Arbitrage Rebate Requirement for Equity-Funded Reserve Funds

Present law. Although present law limits the amount of tax-exempt bond proceeds that may be used to fund a debt service reserve fund to 10% of the bond proceeds, the arbitrage rebate requirement nonetheless continues to apply to debt service reserve funds for most bond issues.

The rebate requirement will continue to apply to these reserve funds throughout the term of the bonds even if all other bond proceeds are spent promptly under a rebate spending exception.

Example. Assume bonds with a term of 20 years are issued to construct a library. Further assume that proceeds of the bonds are used to fund a construction fund and a 10% debt service reserve fund. Even if the amounts deposited in the construction fund are spent promptly within 2 years in compliance with a rebate spending exception, the rebate requirement will nevertheless continue to apply to the reserve fund for the entire 20-year term of the bonds. This result will apply even if the issuer does not comply with a spending exception but nevertheless spends the bond proceeds in due course.

Reason for Change. Except for amounts deposited in a reserve fund, the bond proceeds to which the rebate requirement relates are generally spent within 2 or 3 years of the date of issuance, whether or not a spending exception to the rebate requirement is satisfied. Because a reserve fund is not spent (except to pay debt service on the bonds in the event of unforeseen financial difficulties), present law mandates that the rebate requirement continues to apply for the entire term of the bonds, and imposes costly and cumbersome administrative burdens on issuers associated with recordkeeping and tracking investment earnings on the reserve funds.

To relieve these administrative burdens, issuers should be permitted to disregard debt service reserve funds in complying with the rebate requirement if the issuers fund the reserve funds from their own funds or from the proceeds of taxable bonds. This change should provide an incentive to issuers to decrease the principal amount of bonds burdening the tax-exempt bond market, as more issuers would choose to fund reserve funds from equity and/or taxable borrowings.

5. Increase the Small Issuer Bank Purchase Exception from $10 to $25 Million and Conform to the Small Issuer Exception to the Arbitrage Rebate Requirement

Present law. Banks generally are prohibited from deducting interest on loans used to carry tax-exempt bonds. A small issuer bank purchase exception allows banks to deduct these carrying costs when banks purchase tax-exempt bonds issued by issuers whose total amount of tax-exempt bonds issued in a calendar year does not exceed $10 million (excluding private activity bonds and most current refunding bonds having a principal amount not in excess of the principal amount of the refunded bonds).

Example. If a bank purchases bonds issued to construct a city office building, and if the principal amount of bonds is $10 million or less (taking into account other bonds issued by the same issuer in the calendar year), then the prohibition against deduction of interest on loans to carry tax-exempt bonds does not apply. If, however, the principal amount of the bonds is $10.1 million (or if the issuer previously issued bonds that, together with the office building bonds, exceed $10 million), the issuer is less likely to be able to market the bonds to a financial institution because the nondeductibility limitation applies to the bank and makes the bonds less attractive to a bank as a potential purchaser.

Reason for Change. The purpose of the small issuer bank purchase exception to bank nondeductibility is to preserve the ability of small issuers, with limited access to the capital markets, to place bonds with local banks. Because the cost of capital projects and, as a consequence, the principal amount of bonds necessary to fund capital projects, has increased dramatically since 1986, while the $10 million limitation has remained the same, the principal amount of the exception should be increased. Also, the eligibility requirements for the exception should be conformed to those for the small issuer exception from the rebate requirement, as the slight differences between the statutory language of the two provisions are a trap for the less sophisticated issuers for whom the provisions were designed. Here, in short, it would be much simpler if a single definition of a "small" issuer were used for both the rebate exception and the bank nondeductibility exception. In addition, for the same reasons noted with respect to the recommended change in the small issuer rebate exception, an increase in this exception would provide access to bank purchasers for a disproportionately large number of issuers while affecting a comparatively small amount of bond dollar volume. While it has been suggested that the small issuer bank purchase exception is no longer necessary because of the access to capital markets provided by state-level bond banks and pooled loan programs, many states have no such bond banks or pooled loan programs and many small issuers continue to rely heavily on local banks as their main source of financing. Finally, in the case of an issue of obligations the proceeds of which are to be used to make one or more loans (*i.e.*, pooled financing bonds), an issuer should be permitted to elect to treat each conduit borrower as the issuer of a separate issue. If such an election is made, the bank deductibility provision would apply to each conduit borrower.

6. Repeal 5% Unrelated or Disproportionate Private Business Use Limit on Governmental Bonds

Present law. If private business use is not related or is disproportionate to the governmental use of tax-exempt bond proceeds, then a 5% private business use restriction applies to tax-exempt governmental bonds instead of the general 10% private business restriction on such bonds.

Example. If a governmental bond is issued to finance a courthouse facility which includes a staff cafeteria operated by a private business, a 10% private business use restriction applies to such bond issue because the cafeteria use is treated as related to the courthouse use. If, however, a governmental bond is issued to finance a courthouse which includes office space for lawyers, a 5% private business use restriction applies to such bond issue because the law office use is treated as unrelated to the governmental courthouse use.

Reason for Change. The unrelated or disproportionate use test is cumbersome, inappropriately intricate, and difficult to understand and to apply. The determination of whether a particular use is related or unrelated to a governmental use or whether a use is proportionate or disproportionate to a governmental use can be vague and arbitrary. The application of the test is especially complex in the case of bond issues financing multiple facilities. Out of an abundance of caution, some issuers automatically reduce their otherwise-permitted level of private business involvement from 10% to 5% in governmental tax-exempt bond issues just to avoid the interpretative difficulty of this requirement which seems contrary to the intent of the private business restrictions. The penalty for an erroneous determination is loss of tax-exemption for the entire bond issue. The general 10% private use limit effectively controls excess private business use of governmental tax-exempt bond issues.

7. Modify Private Loan Financing Limit on Governmental Bonds

Present law. If more than the lesser of 5% or $5 million of the proceeds of a tax-exempt bond issue are used to finance a loan to a private person, the bonds generally are treated as private activity bonds (even if there is no private business use).

Example. If tax-exempt governmental bonds are issued in the principal amount of $20 million to finance governmentally-used public housing facilities, up to $1 million (5%) of bond proceeds may be used to make low-interest consumer loans to low-income persons to provide rental assistance. If, instead, no loans were made from this bond issue, then up to $2 million of the proceeds (equal to 10% of the proceeds), could be used to finance housing units to be rented to private businesses without impairing the governmental, non-private activity status of the bonds under the general private business limitations.

Reason for Change. For Federal tax purposes, the distinction between a "use" and a "loan" of bond proceeds is often artificial and is difficult to discern. The main intent of the private loan test was to limit the use of proceeds to make loans to persons not in a trade or business (e.g., consumer loans) in circumstances outside of the existing tax-exempt private activity bond programs, such as single-family housing and student loans. The existing provision also can be interpreted to place an additional, lower private business restriction on loans made to private businesses. Given the complexity of the private loan test limit and the similar policy of controlling private activity bond volume, the private loan test should be modified to be a straight 10% limitation which corresponds to the general private business limitation.

8. Repeal Volume Cap Requirement For Governmental Bond Issues With a Nonqualified Private Business Amount in Excess of $15 Million

Present law. Volume cap is required for tax-exempt governmental bond issues that have private business use or private payment or security that is within the general permitted 10% threshold, but that has a "nonqualified amount" of private business involvement which exceeds $15 million.

Example. Assume that an issuer issues bonds in the amount of $200 million. Because of the $15 million limitation, without obtaining volume cap, the issuer would be limited to $15 million of private business involvement. If, however, this issuer issued two separate issues of tax-exempt governmental bonds in principal amounts of $100 million each, the issuer would be permitted the full 10% amount of private business involvement for each bond issue under the general private business restrictions, which would aggregate $20 million of permitted private business involvement.

Reasons for Change. Mandating that an issuer receive volume cap where the amount of private business use or private payments and security (i.e., the nonqualified amount) exceeds $15 million has no sound tax policy justification. The general 10% private business limits on tax-exempt governmental bonds adequately address the level of private business involvement and should serve as the exclusive restrictions.

9. Repeal Restriction on Governmental Acquisition of Certain Private Output Facilities

Present law. If more than the lesser of 5% or $5 million of the proceeds of a bond issue are used by a State or local governmental unit to acquire a privately-owned electric or gas facility, the bonds generally are impermissible private activity bonds.

Example. Suppose a city determined that it wanted to purchase an existing electric generation or transmission facility to be used by the city to assure reliable electric service for its citizens. Under present law, any bonds issued by the city to finance the acquisition of such an existing electric generation or transmission facility from a seller which was a private utility would be treated as taxable private activity bonds, absent meeting another exception for certain local furnishing of electricity.

Reason for Change. In many circumstances, State and local governments determine to provide electricity or natural gas services to their citizens for reasons which include reducing utility rates, assuring reliability, and assuring adequacy of supply. One appropriate way to accomplish these public purposes may be for the State or local government to acquire output facilities from a private utility. The acquisition may be the result of negotiations on price or the acquisition may be through eminent domain proceedings based on payment of fair market value and a finding that a more important public purpose will be achieved by the acquisition than can be achieved through continued private ownership. The prohibition on the acquisition of privately-owned electric or gas facilities with tax-exempt governmental bonds represents an impairment of the ability of local government to serve their citizens. From a tax policy perspective, State and local governments properly ought to be able to use tax-exempt governmental bonds to carry out these public purposes by financing either new output facilities or acquiring existing privately-owned output facilities.

II. *Simplification Proposals Relating to Qualified Private Activity Bonds and Other Matters*

1. Repeal the Alternative Minimum Tax Preference on Private Activity Bonds

Present law. Although interest on qualified tax-exempt private activity bonds is excluded from Federal gross income, this interest is not tax-exempt for purposes of the Federal alternative minimum tax. Instead, this interest must be included in a bondholder's tax base as an item of tax preference for purposes of computing the bondholder's Federal alternative minimum tax.

Example. If a holder of qualified tax-exempt private activity bonds receives $100,000 of interest on the bonds in a year, that amount is not included in the holder's Federal adjusted gross income for computing the holder's Federal regular income tax. That interest, however, is required to be added to the holder's Federal adjusted gross income base in determining whether the holder is subject to the Federal alternative minimum tax.

Reason for Change. The repeal of the alternative minimum tax preference on tax-exempt qualified private activity bonds will simplify the tax-exempt interest exclusion, enhance market demand for these bonds, and increase market efficiency. In the municipal market, private activity bonds which are subject to the alternative minimum tax carry a punitive higher interest rate. This higher interest cost adds to Federal tax expenditures without a corresponding increase in Federal tax revenues because investors subject to the alternative minimum tax do not purchase these bonds. The proposed repeal of the alternative minimum tax preference on tax-exempt bonds will have increasing market significance as an increasing number of taxpayers are expected to be subject to this tax in future years. The increased demand for tax-exempt private activity bonds from this proposed change should have the effect of lowering the interest rates on private activity bonds by an estimated 10 to 25 basis points. This proposed change should decrease the burden on the tax-exempt bond market and increase Federal revenues.

2. Complete the Repeal of the $150 Million Nonhospital Bond Limitation on Qualified 501(c)(3) Bonds

Present law. The Taxpayer Relief Act of 1997 provided for the partial repeal of the $150 million limitation on qualified 501(c)(3) bonds used to finance facilities besides hospitals for Section 501(c)(3) nonprofit organizations. Vestiges of the $150 million continue to apply to qualified 501(c)(3) bonds in a number of circumstances, including: (i) outstanding bonds issued before August 5, 1997 for capital expenditures; (ii) certain refundings of those bonds; and (iii) nonhospital bonds 5% of the net proceeds of which were used for working capital expenditures.

Example. If bonds were issued in 1996 to construct a Section 501(c)(3) university building, those bonds were, and continue to be, subject to the $150 million limitation. Also, certain bonds now issued to refund those bonds are subject to the limitation. If $50 million of bonds are now issued to finance a Section 501(c)(3) university classroom building and more than $2.5 million (5% of $50 million) of proceeds are used for working capital, then those bonds are also subject to the $150 million limitation.

Reason for Change. The complex analysis and monitoring requirements associated with tracking the continuing vestiges of the $150 million nonhospital bond limitation undermine the tax policy inherent in the predominant repeal of this provision. Many universities and other 501(c)(3) organizations have bonds outstanding which have been issued in furtherance of their charitable purposes in order to fulfill those purposes at the lowest possible cost. The continuance of a small portion of the $150 million limitation into the future may limit the ability to refund those bonds to provide cost savings (i.e., a borrower may not have any room under the cap to advance refund bonds subject to such limitation) or limit the ability to merge or combine with other institutions having outstanding bonds subject to the limitation (i.e., two unrelated organization may not be permitted to merge in the event the new combined entity has in excess of $150 million of bonds allocable to it). The bifurcation regime of having pre-August 5, 1997 non-hospital bonds subject to this limitation, and post-August 5, 1997 bonds exempt from this limitation creates undue tax complexity without any discernible benefit to the Treasury.

3. Eliminate the Specific Identification Requirement for Volume Cap Carryforward for Private Activity Bonds

Present law. Private activity bonds are subject to a statewide volume cap. If the full amount of the cap is not used in any year, the unused portion may be carried forward. To be eligible, a carryforward election must identify the specific purposes of the use of the bonds to be carried forward and must identify the carryforward amount to be used for each identified purpose.

Example. If a local government has been allocated state volume cap in the amount of $30 million in a particular year, and only $25 million is applied to qualified private activity bonds issued in that year, the remaining $5 million may be "carried forward" to subsequent years if an appropriate election is made which specifically identifies the purpose for which the bonds carried forward are to be used. If, however, the specific identification of the carryforward purpose is not made, or if the purpose for which the specific identification is made is not financed, the volume cap is forever lost.

Reason for Change. The complexity associated with monitoring of private activity bond volume cap carryforwards for particular facilities and tracking expirations of elections under a stacking order is unwarranted. Identifying the total amount of the unused private activity bond volume cap in a particular year should be sufficient. Financing circumstances will often change in terms of the facilities and amounts needed to be financed despite an issuer's bona fide expectations at the time of a carryforward election. These circumstances may involve anything from the discovery of environmental hazards on a proposed construction site to an unexpected shift in government priorities.

4. Repeal 25% Land Acquisition Restriction on Private Activity Bonds

Present law. For private activity bonds, only an amount equal to less than 25% of the net proceeds may be used for the acquisition or land or an interest therein.

Example. If private activity bonds in the amount of $10 million are issued by a city to finance a low-income rental housing project, only an amount equal to less than 25% of the net proceeds or $2.5 million may be used to acquire the land on which the facility is to be located, regardless of whether the project is in a high-cost urban redevelopment area or a low-cost rural area.

Reason for Change. The cost of land continues to increase. In some urban areas, for example, the cost of the land may be disproportionate to other project costs when compared to other geographic areas, placing these projects at a disadvantage. There is no sound tax policy reason to penalize tax-exempt private activity bonds in high land-cost areas, such as inner cities with acute redevelopment needs. In light of other, more logical, restrictions on private activity bonds, including the state volume cap on private activity bonds, the land acquisition restriction seems unnecessary. In addition, the substantive requirements relating to the eligible uses of private activity bonds, including the general requirement that costs be functionally related and subordinate to the project purpose, limit the overall uses of proceeds appropriately.

5. Repeal Existing Property Acquisition Restriction on Private Activity Bonds

Present law. For private activity bonds, proceeds generally may not be used to finance existing property unless rehabilitation expenditures in an amount equal to least 15% of the portion of the acquisition costs of building (or 100% for certain other structures) financed with the net proceeds of the bonds are made within a prescribed 2-year period.

Example. If private activity bonds in the amount of $10 million are to be issued by a city to finance the acquisition of an existing low-income rental housing facility consisting of land costing $1 million and a building costing $9 million, then interest on the bonds is not tax-exempt unless $1.35 million (15% of $9 million) is spent for rehabilitation expenditures related to the building within a prescribed 2-year period.

Reason for Change. The existing property acquisition restriction was originally enacted to address concerns regarding accelerated depreciation of tax-exempt bond financed property. Such provisions no longer exist. Moreover, the long depreciation periods for tax-exempt bond-financed property under current law provide a disincentive for this financing. In general, the state volume cap limitation adequately controls the amount of private activity bonds that may be issued to finance existing property. Bond proceeds cannot be used to acquire used equipment, which can be the most cost effective method for a business. The definition of rehabilitation is technical and can require considerable legal analysis. Finally, the 15% rehabilitation requirement for buildings is arbitrary and the 100% rehabilitation expenditure requirements for other types of costs lack a sound policy footing and are unduly burdensome.

6. Overhaul the TEFRA Public Approval Requirement on Private Activity Bonds

Present law. All qualified tax-exempt private activity bonds must meet a public approval requirement prior to the issuance of the bonds. The public approval must be done by the applicable elected representative of governmental unit issuing the bonds and, with certain exceptions, by each governmental unit in which the bond-financed facility is to be located. The public approval can take place only after a public hearing with specified public notice.

Example. If qualified tax-exempt private activity bonds are to be issued by a city to finance a nonprofit hospital located within the city and within another city, the governing body of both cities must approve the bonds after a public hearing. If bonds are to be issued by a state for a multifamily housing facility to be located in a city, the bonds must be approved by the governor of the state (or other designated elected official) following a public hearing.

Reason for Change. While one cannot object in theory to a good government "sunshine" policy in favor of public hearings and public approval, in practice, most State and local governments believe that this TEFRA public approval requirement is costly, cumbersome, and ineffective. Members of the public rarely attend the public hearing required by this provision. This provision often conflicts with or is duplicative of state law requirements relating to the issuance of bonds. These state laws generally require a public hearing when the legislature enacting the state law has determined a hearing to be appropriate and useful Federal tax law should not interfere with what is essentially a local matter regarding the issuance of debt for the facility in question. In addition, this requirement has long outlived part of its original purpose to control private activity bond volume and it predates the volume cap. The private activity bond volume cap is sufficient to control private activity bond volume.

7. Repeal 2% Issuance Cost Limit on Private Activity Bonds

Present law. For private activity bonds, issuance costs financed by the issue generally may not exceed 2% of the proceeds of the issue.

Example. If private activity bonds in the amount of $1 million are issued by a health care authority on behalf of a Section 501(c)(3) organization to finance hospital improvements, then interest on the bonds is not tax-exempt if more than $20,000 of the bond proceeds is spent for issuance costs.

Reason for Change. The 2% bond issuance cost limit reflects undue micromanagement of State and local governmental finance. Other tax-exempt bonds restrictions already provide appropriate economic incentives for issuers to control issuance costs and generally limit tax-exempt bond financed issuance costs to 5% in any event for most private activity bonds. For aperiod of time in the early 1980s, issuers could "recover" the costs of issuance under the arbitrage rules. Thus, if issuance costs were included in the yield on tax-exempt bonds in the arbitrage yield calculation, the arbitrage yield would increase which will permit an issuer to retain more investment earnings not subject to rebate. Changes to the arbitrage rules in the 1986 Tax Act, however, now prevent issuers from "recovering" issuance costs of bonds in the arbitrage yield on their bonds. This change has the effect of restricting the excessive use of proceeds for issuance costs because the issuer must now pay the amounts back for its own funds rather than arbitrage profits, which makes the 2% limit unnecessary. Also, under the private activity bond rules, at least 95% of net bond proceeds must be spent for the private activity project being financed. Finally, the 2% issuance cost limitation imposes a disproportionate burden on small issuers because the dollar amounts of issuance costs do not generally decline as the principal amount of bonds declines.

8. Repeal Special $15 Million Private Business Limit on Governmental Electric and Gas Facility Bonds

Present law. If 5% or more of the proceeds of tax-exempt governmental bonds will be used for an electric or gas output facility, the maximum amount of the bonds that may be applied to private business use is $15,000,000, taking into account proceeds of prior bond issues used for the same project.

Example. Assume that tax-exempt bonds in the principal amount of $100 million are issued to finance a governmental gas generation facility. Under the private business tests, up to $10 million may be used for facilities providing for the take-or-pay sale of output to a private utility under the 10% private business use restriction. If, however, a second issue of tax-exempt governmental bonds of $100 million is issued for the same project, then only $5 million of that issue may be used for such output contract facilities even though 10% of the proceeds otherwise would be permitted to be used for private business use under the general private business restrictions. If, further, a third issue of tax-exempt governmental bonds of any amount is issued for the same project, no proceeds may be used for such output facilities even though 10% otherwise would be permitted under the general private business limitations.

Reason for Change. State and local governmental production and transmission electricity and gas appropriately serve governmental purposes of benefit to the general public. It is punitive and inappropriate to subject those purposes to a special limit other than the general 10% private business use test. Moreover, as a matter of federal energy policy, the existing special $15 million private business restriction may frustrate the Federal Energy Regulatory Commission's efforts to open up the nation's transmission grid to public access.

9. Add An Exception to the Arbitrage Rebate Requirement for All Short-Term Bona Fide Debt Service Funds

Present law. A "bona fide debt service fund" is a fund used to match revenues and debt service expenses each year. These funds generally must be fully depleted each year, subject to certain reasonable carryover amounts. For this reason, bona fide debt service funds are constrained to invest in short-term investments. Bona fide debt service funds are eligible for exceptions to the arbitrage rebate requirement if either: (i) the bonds are governmental, fixed-rate, non-private activity bonds with an average maturity of at least five years; or (ii) the gross earnings on such a fund in a year are less than $100,000.

Example. If governmental tax-exempt bonds are used to construct a public airport runway, and revenues are deposited in a bona fide debt service fund to pay debt service on the bonds, the bond fund is not subject to the rebate requirement if the average maturity of the bonds is at least 5 years and the interest on the bonds is fixed (rather than variable). If, however, private activity bonds are issued to finance terminal facilities leased to airlines, the debt service fund will be subject to the rebate requirement if the gross earnings on the fund in the year are more than $100,000.

Reason for Change. The present law exceptions to arbitrage rebate for bona fide debt service funds are very complex. Yet, at the same time, bona fide debt service fund generally must be depleted annually and typically are invested at yields well below the bond yield because of the inherently short-term nature of the investments. Moreover, bona fide debt service funds may actually "blend down" other higher-yielding investments and thus decrease the amount of rebate owed to the Federal Government. The provision of a blanket exception to arbitrage rebate for bona fide debt service funds will simplify the law and may well have a positive revenue impact in terms of increased rebate amounts to be paid to Federal Government.

Public Finance Network
Washington, DC 20004
October 7, 2004

The Honorable Jim McCrery
Chairman, Subcommittee on Select Revenue Measures
Committee on Ways and Means
U.S. House of Representatives
1135 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman McCrery:

The organizations listed above, which are members of the Public Finance Network, appreciate the Select Revenue Subcommittee of the House Ways and Means Committee's invitation to submit to the record comments on improving and simplifying the tax code. As representatives of a broad coalition of state and local government officials and professionals, we appreciate your willingness to consider changes to the tax laws important to state and local governments and non-profit organizations who issue tax-exempt bonds. Please consider this letter as our submission for the record.

Since the significant changes made to the Internal Revenue Code in 1986, local and state governments and other government authorities have been tackling the complexities incorporated into Code which relate to tax-exempt bonds. The costs of compliance, as well as the costs associated with hiring professionals to assist these entities with their obligations is staggering. We believe that relatively simple changes to the tax code can be made that would save local and state governments billions of dollars in the years ahead.

The burdens of compliance, as well as the sometimes inefficient manner in which governments may utilize the tools available to them to lower their debt burden and save significant amounts of taxpayer dollars, are startling. We believe that Congress should closely examine these issues when it addresses tax simplification measures and tax reform.

At a time when direct aid to local and state governments is decreasing, finding untraditional mechanisms to assist our members has often been discussed by Congress, but rarely addressed in a significant manner. This lack of Congressional assistance, coupled with the struggling budgets that local and state governments have endured over the past few years, have created a situation where governments have had to cut services, delay infrastructure improvements and projects, and neglect joint opportunities with the private sector, all at the detriment of the citizens that are served by every layer of government. We believe that a cooperative approach to addressing these issues between our organizations and the federal government is key to ensure that better and more efficient financial opportunities will exist in the future.

There are many ways in which Congress may help local and state governments through tax simplification and reform measures. While there are many items to consider, we would like to highlight four areas that are critical to state and local governments and other public finance organizations.

Arbitrage Rebate

There is no greater burden to issuers of tax-exempt debt than complying with federal arbitrage rules. This is true both for smaller, less frequent issuers of public debt who often do not have the staff or the sophistication to comply with the rebate requirement and more regular issuers of debt who find themselves bearing enormous administrative costs in complying with the rebate rules as they apply to multiple bond issues. Moreover, these compliance costs are too often disproportionate to the potential arbitrage benefit involved. These issuers need relief from strict arbitrage restrictions that require governmental and non-profit issuers to incur significant compliance costs. Funds that are used to pay rebates and assure compliance could otherwise be used to reduce tax-exempt borrowing.

Two areas in particular require remedy. First, the amount of annual debt exempted from arbitrage rebate restrictions should be raised from $5 million to $25 million. Such a simplification would significantly ease issuers' cost of compliance with the U.S. tax code and, while affecting the *number* of bond issues, it would not significantly affect the *volume* of bond issuance. The inflation rate alone since 1986 would justify a significant increase. Second, extending the spend-down exception from two years to three, as recommended in the 2001 Joint Committee on Taxation's proposal, is a simple, sensible approach to this perennial problem faced by issuers of all types of tax-exempt bonds. Where a bond issue is not issued earlier than necessary and the proceeds are spent within a reasonable time frame, there is no need to subject issuers to the arbitrage rebate requirement.

Bank Deductibility

Targeted liberalization of tax restrictions on "bank deductibility," or bank qualified bonds, would ensure that small governments and charities (e.g., health care and higher education facilities) have access to reasonably priced capital.

The so-called small issuer exemption of $10 million bank eligible level, set in 1986, is unrealistic in the 21st Century. This exemption is meaningless for many small governments that have regular capital needs higher than $10 million and governments often defer needed projects until a subsequent calendar year in order to comply with the $10 million limit in any one year. Additionally, in the face of rising compliance costs that did not exist when the $10 million limit was set, bank eligible financing is an attractive and vastly more efficient vehicle for these smaller entities. We strongly recommend that the level be raised to $25 million and indexed for inflation thereafter.

Furthermore, we believe the ill-fitting and out-of-date exemption from the general restriction on bank qualification, focused as it is on the total annual issuance of the issuer and not the borrowings of the beneficiary, and should instead apply, optionally, at the beneficiary level. Issuers should have the option to apply even the existing exemption at the beneficiary level to bank qualify the bonds. The added savings from this simple, yet significant, change would substantially assist the programs, citizens, patients and students of these governments and charities.

Advance Refunding

In order to provide state and local governments with the tools and flexibility to face changing circumstances, we urge that additional opportunities to advance refund outstanding debt be provided. Issuers currently have only one opportunity to take advantage of favorable market conditions and achieve lower borrowing costs. Given current economic uncertainties that increasingly pinch state and local government budgets and the increased and unforeseen burdens of funding safeguards against terrorism, issuers should be permitted to benefit from the low interest rate environment through additional advance refunding opportunities. Additional opportunities may be accomplished by amending current Code Section 149(d)(3) or by adopting regulations which interpret the term "original bond" as provided in current Code Section 149(d)(3) of the Code to mean the most recent issue issued for a project. Attached to this letter are specific legislative and regulatory proposals with regard to advance refunding.

Expansion of Public-Private Partnerships

Finally, we recommend a relaxation of tax rules related to the use of tax-exempt bonds in public/private partnerships. Many vital economic development projects require significant public commitment combined with private investment. The ability to fund the public share of costs with tax-exempt bonds allows these projects to proceed. Current tax laws and the prohibitions on private use create inefficiencies and higher costs, such that many of these types of projects become financially unfeasible.

For example, publicly funded parking structures integrated with private retail establishments ensure safe and easy access to facilities. Such projects are difficult to fund with tax-exempt bonds, however, because of restrictive private activity bond rules.

We recommend that the threshold test for acceptable private business use be increased, the list of facilities eligible for tax-exempt government bonds be expanded, to increase the private activity cap, and that more flexible allocation rules be developed to facilitate private participation in public projects.

Conclusion

The National Association of Bond Lawyers' (NABL) submission to the Subcommittee addresses many other technical concerns regarding current tax-exempt bond rules. We applaud NABL's extensive comments in this regard, and will continue to work closely with them in the future on these matters.

The struggle for tax simplification, especially in such a specialized area as tax-exempt bonds, is an enormous task and we greatly appreciate your consideration of the concerns that we outlined in this letter. Please do not hesitate to contact Susan Gaffney, Director of the GFOA's Federal Liaison Center if you need further information. We look forward to speaking with you soon on these proposals.

Sincerely,

Susan Gaffney
Government Finance Officers Association

Rick Farrell
Council of Infrastructure Financing Authorities

Rob Carty
International City/County Management Association

Alysoun McLaughlin
National Association of Counties

Chuck Samuels
National Association of Higher Educational Facilities Authorities

Cornelia Schneider
National Association of State Auditors, Comptrollers & Treasurers

Chris Allen
National Association of State Treasurers

Chuck Samuels
National Council of Health Facilities Finance Authorities

Marilyn Mohrman-Gillis
National League of Cities

Larry Jones
U.S. Conference of Mayors

Statement of W. Thomas Kelly, Savers and Investors League, Mirror Lake, Hew Hampshire

This submission pertains to the Individual Investment Account Act (H.R. 3397, 108th Congress) as sponsored by Representative Jim McCrery. This legislation's purpose is to increase our nation's personal saving and investing by taxing such saving and investing only *once*. Such taxation is *vital* and *proper*.

A person can only do only two things with his or her income (e.g. wages): spend it or save it. If income is spent, it's taxed only once. If it is saved and invested, it is taxed multiple times in several ways. All economists agree that the existing income tax is biased against savings. This severe negative bias grows in a compounding fashion as investment durations increase.

Individual Investment Accounts (IIAs) remove the income tax's bias against saving and investing in a simple, fiscally sound, and politically desirable way. IIAs impact *every* person's finances in a positive way. The IIA proposal can sway elections and properly so.

IIAs operate like traditional, tax deductible IRAs thereby providing tax deferred saving and investing. IIAs permit anyone to participate regardless of age, income or employment status. Plan contributions are unlimited. There are no forced distributions at any age nor restrictions or penalties on plan withdrawals. There are no estate taxes at death. Participants and beneficiaries pay ordinary income tax upon any account withdrawal.

Ponder the economic, fiscal and political power of this IIA legislation that is fully described above in just five short, easily understood sentences! Undoubtedly, the initial reaction of many members of Congress will be that the so-called "costs" of this legislation will be too high. The Joint Tax Committee staff will "score" IIAs as being a "tax expenditure" with a probable cost magnitude that's astronomical, but wrong. See comments below.

Commentary

- Nothing is more important to the U.S. economy now and for the future than creating more capital from increased personal saving and investing. Such an increase will reduce the cost of short and long term capital, create jobs, increase wages, and improve standards of living. These powerful increases will compound as the years go by. Further, IIAs will take some of the monetary pressure off of Federal Reserve Chairman Alan Greenspan particularly in terms of curtailing the increase in longer term rates.
- The simplicity of IIAs is dramatic. Multiple intricate sections of the tax code usually dealing with definitions of income vs. gain *become irrelevant* with IIAs to everyone's advantage. Every person understands IRAs and thus IIAs. The administration of IIAs is the same as IRAs.
- People of all ages, ethnic backgrounds, levels of income, family size, etc., will welcome IIAs. They can and will use investment choices (savings accounts, banks, stocks, mutual funds, etc.) that fit their needs and desires as they may change over their lives. IIAs can become their primary depository for savings and investing.
- IIAs provide a vital, most desirable, flexibility for taxpayers as to *when* they pay their income taxes. For example, the tax on a large bonus can be deferred in whole or in part by how much of it is contributed to the person's IIA. Professional athletes with high incomes over a few years can defer their taxes to later years when their incomes are lower. The same can be said for farmers and entertainers who have multiple up and down years in terms of taxable income. This tax deferral flexibility applies not only to income *received* but also as to when the accumulated tax deferred IIA values are *consumed* (spent) and then taxed. Roth-type IRAs provide no tax timing flexibility; you're fully taxed when non-plan income is received.
- Many large and small employers will welcome IIAs. If desired, they can provide higher levels of wages in lieu of some or all fringe benefits. Each employee can then choose the amounts of their own tax deductible savings. Enron-type debacles can be avoided in regards to company stock.
- Competition and innovation will create new fringe benefit plans for personal choice that can substitute for employer-provided plans including life insurance, health insurance and pensions. Various associations (work related or otherwise) or various unions will offer such plans, too. The cost savings and the wider breadth of benefits derived from group underwriting can be achieved. Employers will be able to focus on their core business and not have to be fringe benefit providers, too. Great efficiencies can flow from this realignment of responsibilities that flow from the use of IIAs.

- IIAs are fully portable as people proceed through life with various employers.
- The U.S. media is full of articles about the high levels of existing personal and family debt. IIAs provide the proper free enterprise solution that helps curtail this serious problem. Our existing income tax is biased in favor of spending over saving. IIAs are *neutral* (unbiased) on those ever-present spend or save decisions we all face as we go through life.
- The tax expenditure cost of IIAs as measured under existing tax expenditure budget rules will be a very large finite number but truly useless for rational legislative purposes. The methods used by staff to arrive at the alleged costs are flawed in the extreme. The methods produce losses when gains are occurring and vice versa. After studying the use of tax expenditure costs as applied to tax deferred pension plans, a leader in the actuarial professions concluded that such *tax expenditure costs could only be good by accident!* Other qualified experts have expressed similar views.

Each member of Congress should note that tax deductions for contributions to all qualified plans (e.g., IRAs, IIAs, 401(k)s, etc.) are treated by the tax staff as an *expense*, i.e., a "tax expenditure." However, each person who makes a tax deductible contribution has, therefore, a *liability* to pay a tax upon any account withdrawal. Thus, the government has a tax deferred *asset* of equal amounts to the taxpayer's liability. In reality then the government treats a governmental *asset* as an *expense*! Is it any wonder our government's scoring of tax legislation is so disastrously poor? Each member of Congress should review this *assets-treated-as-an-expense* notion with his or her accounting and economics friends within their state or district constituency. This subject will become one of great interest to all voters as the media becomes more interested in this extremely important matter. The enormous economic damage flowing from this governmental accounting error makes the recent corporate accounting errors look like small change.

- It is important to point out that the Administration's (Treasury Department's) Lifetime Savings Account (LSAs) proposal is virtually identical conceptually with IIAs. LSAs differ from IIAs in only two areas: (1) LSAs have a maximum yearly contribution of $5,000 and (2) LSAs are Roth-type plans (no tax deduction for contributions, and no tax on withdrawals). LSAs are truly a valuable breakthrough in sound legislation except unfortunately, these two limits are self-defeating because:
- Government should not place *any* limits on tax deferred personal saving and investing. Unimpeded by taxes investment growth regardless of amounts and investment duration is vital from everyone's perspective including the government's.
- The LSA limits cited above reduce the so called tax revenue "costs" solely for political reasons. These limits are self-defeating for everyone concerned including the government because they constrain the thing needed most—more (maximum) voluntary personal saving and investing from all sources.
- LSAs, being a Roth-type plan, will be attacked by some legislators (and others) who claim that LSAs create a tax loop hole for the rich because the LSA after-tax saving and investing will never be taxed again.

Individual Investment Accounts (IIAs) avoid the above two LSA problems that were derived solely from political concerns. Unlike LSAs, IIAs have been grass roots tested via polling among many Democrat and Republican oriented congressional districts and the response is overwhelmingly favorable.

Having been an involved taxpayer for over thirty years on this vital subject of governmental taxation of personal saving and investing, I've often asked myself why Congresses and/or Administrations tax capital so harshly and in such a complex, irrational fashion. Conclusion: few legislators are economists, accountants or financial experts. Also, most legislators aren't directly involved in the tax analysis and tax writing process. New legislators soon learn to follow their party leaders with seniority. With the passage of time, too many legislators, while loved by their constituents, gradually assume (not infrequently with staff encouragement) an "us vs. them" (government vs. taxpayer) stature when it comes to drafting legislation. Tax legislation is constantly re-worked to close perceived loop holes that taxpayers might find and use. The net result produces legislation that (1) is virtually unfathomable, (2) is severely biased against everyone's interest, (3) curtails truly vital capital formation and growth, and (4) is worthy of W.C. Fields' famous line "Never give a sucker an even break." Think about it. It's true.

It is urged that each legislator review the League's website at www.savers.org. Tables, using an actual mutual fund's year by year investment performance since

1926, are presented therein that illustrate the real life impact of taxes upon personal saving and investing.

It is appropriate to point out that this Subcommittee's Chairman, Representative Jim McCrery, has been a stalwart sponsor of the Individual Investment Account legislation over several Congresses. Others over past years have described this IIA tax proposal in most favorable terms. For example, Nobel Prize winning economist Dr. Milton Friedman has described IIA legislation as "a great idea." Former Presidential candidate Steve Forbes has described IIAs in the same way. Former House Majority Leader Dick Armey (Mr. Flat Tax) and Representative Billy Tauzin (Mr. Sales Tax) have been co-sponsors. Senator John Breaux (Finance Committee and former DLC Chairman) has been a sponsor in prior Congresses. In short, solid, thoughtful, knowledgeable leaders (there are many others) have supported IIAs over past years. The constant impediment to enactment clearly has been the unrealistic staff scoring of alleged costs that scares away legislative support. The Treasury Department's proposal for Lifetime Savings Accounts (LSAs) demonstrates that fiscally sound, rational, tax deferred saving and investing is in the public interest. Even though LSA legislation is sound and good, IIA legislation is better for all concerned, including the government.

The League will work to educate the grass roots public that the income tax as applied to their personal saving and investing is erroneous taxation that robs them of enormous amounts of investment growth that is properly theirs. This is a pocketbook issue that hits home with everyone.

The League urges all House members of Congress to co-sponsor H.R. 3397. The 109th Congress provides a major opportunity for enactment.