BOB DOLE
KANSAS

United States Senate
OFFICE OF THE MAJORITY LEADER
WASHINGTON, DC 20510

May 15, 1985

TO: Senator Dole

FROM: George Pieler

SUBJECT: Talk to Security Properties meeting

6:45 You are scheduled to talk to Security Properties at ~~7:30~~ p.m. on Thursday the 16th at the J.W. Marriott Hotel, 14th and Pennsylvania. They are interested in the deficit and tax reform, and real estate. Materials on these subjects are attached.

Attachments

REAL ESTATE TAX REFORM ISSUES

A. Indexing Interest

The original Treasury proposal would allow a deduction only for "real" interest paid (i.e., the excess interest over the inflation rate). Similarly, the proposal would limit interest income to the excess over inflation. The proposal would require taxpayers to net interest earned and interest paid and apply a fraction to this amount which is intended to take inflation out. However, Treasury would leave present law for mortgage interst paid on a principal residence and for up to $5000 of other net interest expense incurred by an individual.

Obviously, the interest paid deduction is very important to real estate syndicators who are seeking investors in debt-financed projects. Also, limiting the amount of interst deductions for vacation homes to real interest would have an effect on that market. Most reports indicate that Treasury will drop this provision in their revised proposal.

B. Taxing Large Limited Partnerships As Corporations

The proposal would treat limited partnerships with more than 35 limited partners as corporations. This would mean that the partnership could not pass through deductions to partners. The reason for the 35 partner rule is that Subchapter S corporations which are not subject to a corporate level tax may not have more than 35 shareholders.

Publicly-offered real estate syndications would probably end if this proposal were adopted because they depend so heavily on passing through interest paid and depreciation deductions to the partners. The major problem with the proposal is that it would cause a discrimination between larger investors who can keep under the 35 partner rule and smaller investors who cannot afford a big enough investment to invest in a syndication with no more than 35 partners. Obviously, it will also have a greater impact on large syndications, whether they are publicly offered or not.

The Finance Committee Subchapter C report had a less restrictive rule treating limited partnerships as corporations only if the partnership interests themselves were publicly traded like stock in a major corporation.

C. Elimination of the "At Risk" Exception for Real Estate.

Generally, the total amount of deductions which a taxpayer may take with respect to an investment is limited to the amount he has invested, including debt on which he is personally liable.

However, investors in real estate (and certain equipment leases) may also take deductions equal to their share of debt on which they are not personally liable ("nonrecourse" debt).

The Treasury proposal would make the at risk limitation apply to all investments, including real estate.

The at risk exception allows real estate investors a substantial benefit which is not available to other investors. It is difficult to justify and is a testament to the political power of the real estate industry in past years. As you may recall, the Moynihan minimum tax proposal in 1984 would have effectively repealed the at risk exception for minimum tax purposes. The Finance Committee decided to extend the ACRS recovery period for real estate instead.

Imputed Interest

In addition to basic tax reform, the real estate industry is concerned about the imputed interest and original issue discount rules enacted last year.

The Realtors have endorsed a proposal, introduced by Senator Durenberger, which is even more generous than the 6 month temporary legislation which Congress passed late last year.

Essentially, the 6-month legislation allowed prior law for transactions where debt did not exceed $2 million.

FINAL SENATE BUDGET

PROGRAMS TERMINATED (13)

- Trade adjustment assistance to firms
- Conrail (Sale)
- Appalachian Development Program
- Economic Development Administration
- UDAG
- General Revenue Sharing
- Export-Import Bank Direct Loans
- Community Services Block Grant after 1986
- WIN
- HODAG
- Section 312 Rehabilitation Loans
- U.S. Travel and Tourism Program
- Direct Treasury Payment for most of Postal Subsidy Program

MAJOR ADJUSTMENTS TO ORIGINAL WHITE HOUSE/LEADERSHIP (WH/L) PLAN (DOLE PACKAGE)

- Medicare/Medicaid: reduces 3-year savings from $20.1 billion to $17.5 billion
  - No cap on state medicaid reimbursement
  - No Part B premium increase in 1986. Phased up to 30% over next five years vs. 35% in WH/L plan.
- AMTRAK: 12%/25%/40% cut instead of termination
- SBA: $2.5 billion 3 year savings compromise instead of total termination of lending programs ($5.0 billion savings)

Mass Transit Operating Subsidy: 20% cut instead of 5-year phase out

Impact Aid Part B: Freeze at 1984 level ($78 million) instead of termination

Postal Subsidies: Small newspapers and non-profits retain subsidized rates. Substantive legislation to limit program abuses, improve overhead allocations and spread part of subsidy cost over all regular rate users.

Agricultural Programs: $3.5 billion added back to WH/L plan plus following programs:

- New export incentive program using CCC stocks to counter foreign subsidies
- New farm credit interest rate buy-down program
- $1 billion per year add on for farm credit guarantees
- No change in Federal crop insurance
- Soil and water conservation cut reduced from 30% to 15%
- Compromise on REA

Job Corps: 30% cut instead of termination

Student Aid: Freeze on student assistance at 1985 level and $200 million savings in GSL programs. No $8,000 cap on cost of education (Stafford compromise)

NIH Grants: 6,000 new research grants per year vs. 5500 in WH/L policy decisions--in terms of priorities among spending program--that have to be made if we are serious about the deficit problem.

- Over the past three years deficits have totalled $606 billion: an average of 5.7% of GNP. That is just not sustainable if we want to continue a strong economic recovery.

- If we do nothing, the situation gets much worse, even under optimistic projections: $716 billion in additional deficits over the next three years.

- Under the compromise Deficit Reduction Plan, Federal borrowing as a percent of private savings would decline from an estimated 78% this year to 30% by 1988. That will dramatically reduce pressure on credit markets due to Treasury borrowing--free available capital for private investment and job creation--reduce interest rates, and help our trade position.

- Even with this budget plan, we will still be spending an enormous amount to meet the basic needs of our citizens. Nondefense spending still will increase each year, from $520 billion in 1984 to $583 billion in 1988. Similarly, combined Medicare and Social Security spending will continue to rise--from $232 billion in 1984 and $293 billion in 1988: nearly 7 times the amount that wao spent on those programs in 1970.

- Means-tested safety net programs are kept intact and will continue to grow as scheduled under present law. By 1988, safety net spending will still exceed the 1980 level by 72%.

- Agricultural programs will undergo major reforms, but by 1988 we will still be spending between $13 billion and $15 billion a year--much higher than any year before 1980. And don't forget that over the past three years we spent a record $53 billion on farm programs, while largely doing the agricultural economy more harm than good.