Pfizer Luncheon April 1
Sheraton Grand
Ballroom Center

MEMORANDUM

March 31, 1987

To: Senator Dole
From: Mark Bisnow
Re: Pfizer dinner

You are scheduled to make remarks Wednesday evening at a dinner of 100 Pfizer executives at the Sheraton Grand.

60 of the 100 executives are operations or personnel managers with Pfizer from its facilities around the country. The other 40 are VPs from the New York headquarters. This meeting is held every couple of years to familiarize the Pfizer people with current Washington issues and personalities. I am told you may have addressed this group in 1983 or 1985.

You will be introduced by Steve Conafay, the Washington-based Pfizer VP who has worked there for 10 years. A reception is being held between 6:15 and 7:15, but as soon as you arrive the plan is to usher everyone into the ballroom where dinner is being served. You will then speak before dinner is served and may leave as soon as you are done. The organizers say you can have 30 minutes or more, but I imagine people will be getting hungry Bhile you speak. They would like you to allow time for Q&A.

The group arrived in town Tuesday morning and stays until Thursday. They are hearing from Boschwitz and Boren on political action committees, from Claudine Schneider and Jeff Bingaman on competitiveness, Tom Foley on the Democratic agenda, some staff people on intellectual property and catastrophic health insurance, and Pfizer's chairman, Ed Pratt (who won't be at your event) on the state of their company.

The theme of the Pfizer meeting is "competitiveness," and they have defined that in their letter to you as an interest in intellectual property rights protection, a pemanent repeat of Section 861 r&d allocation requirements, preservation of the r&d tax credit, and tort reform legislation that includes a government standards defense. They have also mentioned that yu might be asked questions on PAC reform legislation.

Attachments.

1. Talking points on: competitiveness, Section 861 allocation of r&d expenditures, r&d tax credit, tort reform, intellectual property rights protection.

2. Invitation letter from Pfizer.

3. Memo from Rich on taxes.

PFIZER WASHINGTON GOVERNMENT RELATION'S SEMINAR
Capitol Hill Sheraton Grand Hotel

April 1, 1987

Competitiveness

- The Administration's competitiveness bill, which I introduced on February 19, has been parcelled up among six committees, some of which are more likely than others to report favorably. The committees include Finance, Judiciary, Energy, Labor, Commerce, and Banking.

  Senator Byrd has asked committees to conclude their markups sometime in May, and has told the President he hopes to have a bill to him by mid-summer. This may or may not be realistic. The House appears to be on track, however: Ways and Means has reported the basic trade component, and Banking as well as Energy and Commerce are moving on important components as well.

- Major provisions of the bill include: a $980 million worker readjustment program to offer counseling, job training, and job search assistance; funding for expanded youth training programs; a doubling of the National Science Foundation budget over five years; and intellectual property protections.

- Also: product liability reform which would limit compensation for noneconomic damages to a fair and reasonable amount and retain a fault-based standard of liability; antitrust reforms which would amend the Clayton Act to distinguish between pro-competitive mergers and anti-competitive mergers; reforms in trucking regulation, oil pipeline and natural gas regulation to reduce costs to business and consumers.

- Also: relaxation of export controls which don't impinge on national security; continued financial services deregulation; and a beefing up of trade statutes to streamline relief for import-sensitive industries and to assure actions against closed foreign markets.

R & D Tax Incentives

- I understand that the Administration intends to have proposals on both the so-called "861 allocation" rules and the incremental research and development credit. It is my understanding, however, that the Administration may not propose specific items to offset the revenue loss. Rather, they are more likely to suggest that the provision somehow be handled as part of the budget reconciliation process.

- The Finance Subcommittee on Taxation has scheduled a hearing on the subject of research incentives for this Friday. I will be interested in what the Treasury Department's official position will be at the hearing. It is likely that they will announce their position on the 861 allocation issue, but not their position on the R & D credit.

Section 861 Allocation of Research and Development Expenditures

- In the late 1970's, the Treasury Department published regulations which would have forced multinational taxpayers to allocate a portion of their U. S. research expenses to foreign source income if the research were related to the foreign income. This would have had the effect of raising U. S. taxes of taxpayers who were in an "excess credit" position, that is, those who pay more in foreign taxes than they are allowed to credit against their U. S. tax liability.

- Congress was not satisfied that those regulations reflected Congressional intent and suspended the regulations.

- One of the primary arguments made by multinational corporations in opposition to the regulations is that, if the Treasury regulations were allowed to go into effect, these companies would be encouraged to perform more of their research outside the United States.

- We recognized, however, that just limiting the ability of the IRS to enforce the law was not an adequate way of doing our job. Many of us in Congress were concerned that there might, in fact, be a problem with the sourcing rules. But, more importantly, we were convinced that this issue should be resolved by Congress, rather than relying on Treasury Department interpretations.

- Therefore, as part of the Tax Reform Act last year, we provided a rule for determining how to allocate these expenditures between U. S. and foreign source.

- It was recognized that this would have to be a temporary rule, and, in fact, the rule expires in August. The revenue cost was a major factor in determining that the rule would apply for such a short time. In addition, the Treasury Department argued at the time that there was a need for an opportunity to analyze the impact of the Tax Reform Act on these multinational corporations.

Intellectual Property Rights Protection

The following are proposed reforms under the President's competitiveness legislation:

- Section 337 of Tariff Act of 1930. This is the law which permits injunctions against patent infringement by foreign firms, and the bill would eliminate the key requirements of proof in making cases before the ITC, making relief much easier to obtain. Specifically, a petitioner would no longer have to show that injury occurred, or that a substantial industry exists which is affected. The consequence of this change would be to eliminate many delays and expenses associated with 337 cases. The Senate bill is fairly similar, and therefore this provision, while significant, is considered non-controversial.

- Process patents. Owners of U.S. process patents would be able to go to court against foreign patent infringers, a right which, incredibly enough, they do not now have. This provision is opposed by generic drug makers and retailers, who don't want to pay for the processes they use and argue, therefore, that this change would raise costs to consumers.

- Digital audio tape recorders. The bill would require copy code scanners to be placed in these recorders to prevent home recording of tapes. The recording industry is, of course, pushing this "technological solution," but consumer groups are opposed. Other industries wonder why such protections are not afforded to Xerox and other types of copiers.

- Berne Convention. The bill would establish U.S. membership in this copyright convention to which most all countries now belong. The U.S. resisted membership historically because the life of a copyright under our laws was different from that under the convention, but our laws have now changed so that there is no difference. Therefore, this provision is expected to be non-controversial, although in the eyes of USTR it is very significant because they say it will give us much more credibility in making intellectual property arguments to other countries.

- Patent term extensions. An automatic five-year extension would be allowed for patents of agricultural, animal drug, and chemical product patents, added on to their regular 17-year patent. This is because much of the life of the patent is taken up by federal regulatory reviews (e.g., FDA testing and approval); a five-year extension is already allowed for pharmaceutical products.

- Antitrust standards. The bill would require that technology licensing agreements always be judged under a "rule of reason" standard rather than, as is sometimes the case now, a "per se" standard. This is opposed by gung-ho antitrust advocates, who believe the per se rule makes prosecutions more frequent. On the other hand, it would tend to help small businesses which get trapped by the per se standard even though their activities don't have any serious anticompetitive effects.

- Patent misuse doctrine. Under present law, a patent licensee can challenge a licenser on grounds of patent abuse and, if proven, the court is required to invalidate the patent. This remedy is considered draconian, and therefore the Administration's bill would limit those circumstances in which it could be imposed.

Tort Reform and Liability Insurance

- Many people look at the issue as an insurance crisis. For example, manufacturers cannot get insurance against product liability claims and doctors can't get malpractice insurance. Or they can get insurance, but the premiums are so high that businessmen can't afford them and still stay in business.

- Unfortunately, it is an oversimplification to assume the insurance companies are just overcharging for insurance. The insurance industry has the responsibility to prove that the premium increases are justified. As premiums rise, there will be increased pressures both at the State and Federal levels for more oversight. However, there is little question that our laws relating to personal injury contribute much to the problem and could use substantial revision.

- Much has to be left to the states since state courts have jurisdiction in many of these cases. However, especially in the product liability area, we can and ought to act at the Federal level.

- Last year, the Administration proposed some significant changes in the tort laws, including limits on the amount of noneconomic damages an individual could recover in court. Senator Danforth, who was then chairman of the Commerce Committee, led his Committee to report product liability legislation which included limits on noneconomic damage awards, changes in the statutes of limitation and repose, and restrictions on the doctrine of joint and several liability.

- Unfortunately, although the Commerce Committee was debated on the Senate floor, opposition from Senator Hollings, who is now chairman of the Commerce Committee, and others, made Senate passage impossible.

- Democratic control of the Senate will make the needed reforms more difficult to achieve, but this issue is too serious to be treated as a partisan matter, and I am hopeful that at least some of the proposed reforms will have a reasonable chance of being enacted in this Congress.

- I am encouraged that the American Bar Association has begun to recognize the need for revision of our tort system. Although they voted against ceilings on damage awards at their midyear meeting in February, they endorsed proposals to make recovery of punitive damages subject to a higher standard of evidence, to give judges more power to reduce excessive jury verdicts, and to modify the doctrine of joint and several liability so that defendants would be liable only for their proportionate share of noneconomic damages while remaining fully liable for economic damages.

- This is a small step, but it is a step in the right direction.

- The Administration's Tort Policy Working Group issued an update on tort reform and insurance availability last month. The update notes that the availability problem has eased somewhat in most lines of insurance and premiums seem to have leveled off, although at much higher levels. On the other hand, jury awards seem to be increasing at a very high rate.

- The report also notes that there is an increasing consensus in the legal community that punitive awards are a substantial source of litigation abuse, and that much of the problem is a result of major changes in tort law itself over the last several years which have had the result of increasing plaintiffs' likelihood of obtaining compensation.

- The Administration has included a tort reform segment as part of its competitiveness package, and they intend to work for passage. Realistically, in the short run there may be more chance for substantial reform at the state level, both because of the make-up of the Congress and because so much of tort litigation occurs in state courts.

BOB DOLE
KANSAS

United States Senate

OFFICE OF THE REPUBLICAN LEADER
WASHINGTON, DC 20510-7020

April 1, 1987

M E M O R A N D U M

TO: SENATOR DOLE

FROM: RICH BELAS

SUBJECT: LOBBYING EFFORT ON RESEARCH TAX INCENTIVES

I have prepared some talking points on R & D tax incentives for your Pfizer event this evening. The talking points are fairly sympathetic, but I thought you might want some background on what has been happening recently in the area.

There are two research tax incentives which are scheduled to expire in the near future: the so-called "Section 861 allocation" rule and the incremental tax credit for research and development expenses.

The 861 allocation rule expires this August. The R & D credit expires at the end of 1988. The groups interested in these incentives are now lobbying primarily for the 861 allocation rule because it expires first and because they think they can be more succesful if they do not lobby for both incentives at the same time. They are very expensive.

Simply extending the 861 allocation rule through 1992 would cost $2.4 billion, and would benefit a small group of large corporations -- probably fewer than 100 companies. Treasury evidently has agreed to propose a permanent rule that would cost even more -- $3.2 billion through 1992. Treasury, however, will not propose any revenue offsets. That, evidently, will be left to Congress.

Making the R & D credit permanent at the current 20 percent rate would cost an additional $4.3 billion through 1992.

BACKGROUND ON 861 ALLOCATION RULE

The 861 allocation rule determines when a multinational corporation has to allocate a portion of research expenses incurred in the U. S. to foreign income for foreign tax credit computations. Generally, under the original regulations, such expenses would be allocated to foreign income when the U. S. expenses directly affected the income earned abroad. The temporary rules enacted last year state that 50 percent of these expenses are to be allocated to U. S. income.

The importance of the allocation is that, if a multinational corporation pays substantial foreign taxes, it can be caught by the foreign tax credit limitations in U. S. law and not be allowed to credit all foreign taxes they pay against U. S. income tax liability. If expenses are allocated to foreign income, that can lower the amount of foreign tax that can be credited against U. S tax. This results from the way the foreign tax credit limitation is calculated.

Conceptually, the allocation of expenses to the income they generate makes sense. As you may recall, this is similar to the argument for modifying the Section 936 possessions tax credit in 1982. However, there are a small number of very large multinationals, including Pfizer, who argue that they will conduct their research outside the U. S. if the the Treasury allocation regulations went into effect.

Treasury will testify before the Finance Subcommittee on Taxation this Friday. They are expected to announce support for the $3.2 billion compromise, but they are not expected to propose any way to pay for it. They also are not expected to propose anything specific on the R & D credit.