OPENING REMARKS OF SENATOR DOLE

NATIONAL ASSOCIATION OF HOME BUILDERS--HOUSTON, ~~TEXAS~~

astrodome

JANUARY 21, 1984

THE THEME OF TODAY'S DISCUSSION, "THE GREAT DEFICIT DEBATE," IS UNDERSTANDABLE. THE DEFICIT IS ON EVERYONE'S MIND. BUT, IF YOU WILL PARDON MY SAYING SO, YOUR THEME IS SOMEWHAT MISLEADING. THERE IS NO DEBATE OVER THE DEFICIT. IT IS A PROBLEM, A SERIOUS PROBLEM, AND EVERYONE KNOWS IT. THE DEBATE IS OVER THE ECONOMIC RECOVERY--HOW LONG WILL IT LAST WITH THESE HIGH DEFICITS, AND WHEN WILL THE MOMENT OF TRUTH COME. BECAUSE IT <u>WILL</u> COME, WHETHER IN THE FORM OF A THREAT OF RENEWED INFLATION OR IN THE FORM OF A FALTERING ECONOMY WITH HIGH INTEREST RATES, INADEQUATE INVESTMENT, AND LOST EXPORT OPPORTUNITIES.

I HAVE NO DOUBT THAT MY COLLEAGUES TODAY AGREE WITH THIS. I BELIEVE THAT PRESIDENT REAGAN AGREES WITH IT, AND I BELIEVE SPEAKER O'NEILL AGREES WITH IT. WHY THEN IS THERE NO CONSENSUS ON DEALING SWIFTLY WITH THE DEFICIT THREAT?

THE ANSWER IS THAT, WHILE EVERYONE KNOWS THE RISKS POSED BY MAMMOTH DEFICITS, THERE ARE OTHER RISKS TO BE CONSIDERED AS WELL. THEY ARE LARGELY POLITICAL IN NATURE. THE PRESIDENT RIGHTLY DOES NOT WANT TO SEND OUT A CALL FOR SACRIFICE IN THE NAME OF TACKLING THE DEFICIT IF HAS REASON TO FEAR PARTISAN ATTACKS THAT COULD THREATEN HIS ADMINISTRATION AND HIS SUPPORTERS IN CONGRESS. IN A SIMILAR WAY, SPEAKER O'NEILL NO DOUBT FEARS PROPOSING SPECIFIC STEPS ON THE DEFICIT THAT REPUBLICANS CAN TEAR APART IN AN EFFORT TO SCORE POLITICAL POINTS. THESE ARE THINGS WE IN CONGRESS ALL UNDERSTAND, ONLY TOO WELL.

IMPASSE

BUT THERE SHOULD BE A WAY OUT OF THIS IMPASSE. I HAVE SUGGESTED ON MANY OCCASIONS THAT THE PRESIDENT AND THE SPEAKER SIT DOWN TOGETHER, GET A DIALOGUE GOING, FIND OUT THE AREAS WHERE THEY WILL NOT COMPROMISE AND SKETCH OUT SOME POSSIBLE GROUNDS FOR CONSENSUS. I BELIEVE THOSE GROUNDS EXIST, AND THEY COULD BE BUILT ON IF THE ELEMENT OF PARTISANSHIP COULD BE REMOVED--YES, EVEN IN AN ELECTION YEAR. BUT UNLESS THE DIALOGUE TAKES PLACE AT THE HIGHEST LEVEL, WE MAY BE DOOMED TO A WAITING GAME. THE POLITICAL RISKS ARE TOO HIGH, HOWEVER GOOD THE INTENTIONS OF MEMBERS OF CONGRESS, FOR US TO GO IT ALONE.

SO WHILE PRESIDENT REAGAN MIGHT PREFER TO WAIT AND SEE HOW THE RECOVERY PROGRESSES, AND SPEAKER O'NEILL MAY WANT TO RUN A CAMPAIGN ON THE DEFICIT ISSUE, THIS IS ONE TIME WHEN THOSE PREFERENCES, AT LEAST IN MY VIEW, OUGHT TO BE PUT ASIDE IN THE INTEREST OF THE PUBLIC AT LARGE. CONSIDER WHAT IS AT STAKE.

THE CASE OF HOUSING

CONSIDER THE SITUATION IN YOUR OWN INDUSTRY. HOUSING HAS HAD SOME ROUGH TIMES IN RECENT YEARS, NO ONE HERE NEEDS TO BE REMINDED OF THAT. BUT RECENTLY THE SIGNS HAVE BEEN GOOD, BETTER THAN MANY EXPECTED. HOUSING STARTS IN 1983 WERE AT 1.7 MILLION, SIGNIFICANTLY BETTER THAN MOST EXPERTS PREDICTED EARLY LAST YEAR. NEW HOME SALES WERE UP BY 91% OVER THE RECESSION LOW. HOUSING STARTS HAVE DOUBLED SINCE NOVEMBER 1981.

WHAT IS MORE, AND HIGHLY SIGNIFICANT FOR THE LONG TERM, THE HOUSING AFFORDABILITY INDEX HAS IMPROVED DRAMATICALLY. BY THE END OF 1983 THE INDEX HAS RISEN 15% SINCE JANUARY OF 1981. THAT MEANS THREE MILLION MORE AMERICANS CAN AFFORD TO OWN THEIR OWN HOMES THAN COULD DO SO WHEN PRESIDENT REAGAN TOOK OFFICE. THAT IS NOT ONLY GOOD NEWS, IT IS A TRIBUTE TO THE PROGRESS WE HAVE MADE ON THE INFLATION AND INTEREST RATE FRONTS UNDER PRESIDENT REAGAN. IT IS PRECISELY THAT PROGRESS THAT IS THE KEY TO SUSTAINING YOUR INDUSTRY, AND THE ECONOMY AS A WHOLE, IN THE YEARS AHEAD. AND IT IS PRECISELY THAT PROGRESS WHICH IS THREATENED BY TRIPLE-DIGIT DEFICITS.

TO AVOID CRISIS

WE MUST NOT RETURN TO THE CRISIS MANAGEMENT OF THE LATE 1970'S, WHEN AT TIMES WE SEEMED TO HAVE A NEW ECONOMIC POLICY EVERY DAY. PEOPLE HAVE NOT FORGOTTEN 21% INTEREST RATES AND 13% INFLATION. PRESIDENT REAGAN PLEDGED TO PLAN FOR THE LONG-TERM, NOT FOR THE QUICK FIX. AND HE HAS KEPT THIS PLEDGE. HE GOT OUR TAX BURDEN UNDER CONTROL, HE SOUGHT AND WON TOUGH SPENDING CUTS. HE SUPPORTED THE FEDERAL RESERVE'S ANTI-INFLATION FIGHT. IN DOING ALL THIS HE HAS LAID THE GROUNDWORK FOR A SOUND ECONOMIC FUTURE.

BUT THERE IS ONE MORE BATTLE TO FIGHT, AND IT MAY BE THE TOUGHEST OF ALL. THE PRESIDENT HAS WON IN THE PAST BECAUSE HE SET AN AGENDA THAT THE PEOPLE SUPPORTED AND UNDERSTOOD, AND BECAUSE HE WON THE COOPERATION OF CONGRESS. THAT IS WHAT I HOPE HE WILL DO ON THE DEFICIT.

THE AMERICAN PEOPLE DO NOT SUPPORT THESE HUGE DEFICITS. THE PRESIDENT AND THE CONGRESS ARE DEAD-SET AGAINST THEM, BECAUSE THEY UNDERSTAND THE THREAT TO ECONOMIC STABILITY THEY REPRESENT. BUT WHEN WE ARE FACED WITH A RESULT NO ONE WANTS, SOMEONE HAS TO SHOW THE WAY TO A BETTER RESULT. SOMEONE HAS TO TAKE THE LEAD.

I BELIEVE PRESIDENT REAGAN AND SPEAKER O'NEILL CAN DO THE JOB. THE PRESIDENT HAS WARNED OF THE DANGERS OF DEFICIT FINANCE FOR MANY YEARS, AND THE PUBLIC HAS LARGELY HEEDED HIS MESSAGE. IT WILL DO SO AGAIN. WHILE I SHARE THE PRESIDENT'S PREFERENCE FOR SPENDING RESTRAINT AS A TOP PRIORITY, WE HAVE TO RECOGNIZE THE REALITY OF THE 100-VOTE MARGIN IN THE HOUSE HELD BY OUR COLLEAGUES ON THE OTHER SIDE OF THE AISLE.

THERE IS NO WAY AROUND BIPARTISAN CONSENSUS-BUILDING IF WE WANT TO TACKLE THE DEFICIT. IT IS AN OPPORTUNITY TO BE SEIZED, NOT A RISK TO BE FEARED. THE RISK LIES IN FAILING TO ACT. IF WE DO NOT DO THE JOB THIS YEAR, WE WILL HAVE TO DO IT NEXT YEAR. EACH DAY THAT PASSES WITHOUT ACTION ON THE DEFICIT MAKES THE JOB TOUGHER. WHEN THE STAKES BECOME CLEAR TO EVERYONE--IN TERMS OF JOBS, TRADE, GROWTH, STABLE PRICES, AND EXPANDING OPPORTUNITY--THEN WE WILL ACT. LET US WORK TO MAKE SURE THAT DAY COMES SOONER RATHER THAN LATER.

United States Senate

COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

January 18, 1984

Sec. Dole

TO: Senator Dole

FROM: George Pieler

SUBJECT: Materials for Homebuilders talk

Attached are materials for your presentation to the National Association of Homebuilders in Houston on January 21. The format will be a brief statement from each of the participants, followed by questions from the moderator (Bryant Gumbel) and some submitted by the audience.

Participants are Gerald Ford, Bob Dole, Jim Jones, and Jim Wright.

Attached are a brief opening statement and talking points on several issues of interest to the Homebuilders: partnership tax shelter rules, collapsible corporations, and individual housing accounts. Some in the group may also be interested in section 167(k) of the tax code, which expired at the end of 1983. This provision allowed five-year writeoff of expenditures for rehabilitating low income rental housing, and Senator Moynihan has introduced legislation, S. 2089, to continue the incentive for 10 years.

The staff has made no recommendation on reviving this provision, but it is being reviewed in light of possible revenue effect, need for additional incentives in the housing area, etc. Efficiency of this kind of subsidy is a major issue.

Attachments

PARTNERSHIP TAX SHELTER PROVISIONS

- o The form of entity most commonly used to maximize tax benefits in a tax shelter investment is a partnership.

- o A partnership does not incur income tax liability; rather individual partners are taxed on their share of partnership income and deduct their share of partnership losses.

- o The limited partnership is generally preferred over the general partnership for tax shelter investments because the limited partners are generally passive investors, who, like corporate shareholders, have limited liability for the debts or claims against the partnership and because limited partnership interests can be readily sold.

- o Starting with the Tax Reform Act of 1976, the "at risk" limitation on deductions has generally limited some of the tax shelter abuses. However, there are still a number of tax abuses in the partnership area that need to be addressed.

- o By using special item allocations, it is possible to structure a partnership so that those partners desiring tax shelter can show a tax loss from the partnership on their return even thorough the partnership has taxable income.

- o The current Treasury proposal would prohibit special allocations of separate items such as income, gain, loss deduction or credit.

- o I understand the impact this proposal would have on the real estate industry and your ability to fund projects. Typically, limited partnerships are used in the real estate industry as an investment vehicle in order to attract capital. I do not believe these are necessarily tax shelter schemes and we are considering exempting certain items such as depreciation and depletion from the item allocation provision to minimize the impact in the real estate and oil and gas areas. No final decisions have been made as yet.

- o Under the Treasury proposal, retroactive allocation of partnership deductions generally would be prohibited in some partnership arrangements. In addition, any gain, loss, depletion or depreciation on property contributed to a partnership would have to be allocated to the contributing partner.

- The Treasury proposal would include a provision to prohibit the allocation of partnership income to avoid capitalizing certain organization and syndication fees. The proposal would also deny tax-free, like-kind exchange treatment for exchanges of partnership interests in different partnerships.

Individual Housing Accounts

Senator Wallop has introduced legislation, S. 1435, to provide for the established of IRA-like savings accounts to accumulate funds for the purchase of a home. Senator Dole is a cosponsor, and the concept is similar to the housing and education savings accounts Dole first proposed in the 96th Congress.

Proposal

Under S. 1435, an individual could receive a deduction of up to $1,000 ($2,000 for joint returns) per year for contributions to a home savings account, for a 10-year period. The deduction allowable is phased down above $50,000 in income, and contributions must be used for a home purchase by the end of the 10th year after the initial contribution, or within a year after contributions cumulate to $10,000. Funds used for a home purchase would be recaptured as ordinary income over a 10-year period.

Talking points

- IRA-type housing savings accounts, whether under this proposal or a similar one, can help boost savings and capital investment in the future. At the same time, it can give Americans a major boost towards becoming homeowners, at a time when years of inflation and economic uncertainty have made that goal more difficult to achieve for many of our citizens.

- At the same time, we do have to be concerned about the revenue cost of any new tax incentives we may want to enact. Adding to the deficit is no way to boost savings and investment over the long term. The the limitations in this particular proposal should help limit the revenue loss, since all that is being proposed is tax deferral--and it may be possible to identify other changes in the tax code that could generate offsetting revenues and ensure revenue neutrality.

- Overall, the housing account concept deserves serious consideration as an incentive to potential home buyers and a potential boost to the long-term prospects for our economy. Even though housing has made substantial gains since recovery began, we need to ensure that those gains are enduring and not part of a return to the inflation-deflation roller coaster.

CONVERSION OF ORDINARY INCOME INTO LONG TERM CAPITAL GAINS THROUGH "COLLAPSIBLE CORPORATION" TRANSACTIONS

Present Law and Background

The collapsible corporation rules of the tax code are designed to prevent taxpayers from converting ordinary income into long-term capital gains by operating through a corporation that is liquidated or "collapsed" prior to the realization by the corporation of income attributable to the corporation's business activities. The rules generally treat as ordinary income (rather than capital gains) gain from certain liquidations of "collapsible corporations", and gain from sales or exchanges of stock in such corporations.

Collapsible corporations are generally defined as corporations used with the intent of selling or exchanging the corporation's stock before realization by the corporation of a substantial part of the income to be derived from the corporation's business activities from the manufacture, construction, production, or purchasing of property. The courts have split on the issue of whether this test requires that a substantial majority (e.g., two-thirds) of the corporation's business income be realized on the corporate level, or whether a smaller amount (e.g. one-third) is sufficient. The IRS has acquiesced in the court decisions allowing the collapsible corporation device to be used as long as no more than two-thirds of the income involved is converted from ordinary income into capital gain.

Explanation of Proposal

The collapsible corporation would be amended to clarify that at least two-thirds of the corporation's income must be realized on the corporate level to avoid collapsible corporation treatment. Limitations on the collapsible corporation rules would also be amended to allow an exception only where one-third or less of the corporation's gain is attributable to so-called "collapsible assets." The proposal would be effective for transactions after the date of Senate Finance Committee action on the proposal.