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

June 18, 1985

TO: Senator Dole
FROM: George Pieler
SUBJECT: Talk to National Realty Committee

You are scheduled to talk to the National Realty Committee this evening between 7 and 8 p.m. at the Four Seasons.

They are mainly interested in tax reform: talking points on real estate issues raised by the President's plan are attached. In addition, members of the group are generally opposed to the administration's so-called 'windfall' or 'recapture' tax for recouping depreciation benefits in connection with lowering tax rates (no surprise, since hardly anyone other than the administration supports that publicly).

They are not opposed to the proposed new depreciation schedules for real estate, but think the computations are unnecessarily complex. They have the same view of the minimum tax proposal in the President's plan.

The group has no objection to shutting down real estate tax shelters where tax benefits are the only point of the deal--they believe the deals they syndicate have real economic substance.

Also attached are current budget materials.

Attachments

NATIONAL REALTY COMMITTEE

TAX TALKING POINTS

Effective Date of Capital Cost Recovery System and Binding Contracts

- The President's proposal would apply the new depreciation schedules to property placed in service after 1985. No binding contract rules are specified. The reason for this is that the Administration believes that grandfather and transition rules generally are the prerogative of Congress. They also believe that saying that the effective date will be in the future and there will be a binding contract rule would cause a rush to get binding contracts before the effective date.
- It is impossible to predict now what the effective date will be and what transition rules such as binding contract rules will apply. It is likely, however, that there will be an effort to avoid having a "window period" between date of Committee action and the general effective date to get binding contracts signed.

Low Income Housing

- The President's proposal puts low income housing in the same cost recovery class as other real property. It is too early to say whether there will be a successful effort to get more generous treatment for low income housing.

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.
- The President's proposal would extend the at-risk limitation to 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.

- It would not be surprising if the at-risk exception for real estate were, in fact, repealed as part of the tax reform effort.
- Deductibility of Interest
- The President's proposal is tougher on investment interest paid than the original Treasury proposal. The Treasury proposal would have limited net interest paid over \$5,000 to interest adjusted for inflation. The new proposal would deny the deduction for investment interest paid completely to the extent it exceeds investment income plus \$5,000.
- So far, this change has not received much attention but it is still very early in the process.

Budget Deficit as Top Priority

- House and Senate conferees on the FY 1986 budget will meet for the first time today. They have a tremendous challenge: to agree on a major deficit-reduction package that will keep recovery on track, both by the magnitude of the savings and by guaranteeing that the plan will be carried out fully in the years ahead.

- Let's not forget that the deficit is our number one domestic problem. By the same token, getting the budget on a 'glide path' toward balance could be a historic breakthrough for our economy: sustaining recovery for the rest of this decade without reigniting inflation. That's why everyone should focus very, very closely on the actions of the budget conferees.

- Another reason for keeping an eye on the budget is the debate over the actual savings, and over how shifts in the economy may affect the deficit projections. Some say the deficits will be higher than we thought, even if we approved the Senate budget in its entirety. If that's so, the conferees ought to aim even higher in total savings--they have to hit the mark of a deficit at 2% of GNP in 1988, or come as close as possible. There are enough different items in both budget packages to make that possible.

- To evaluate how well the budget conferees do, watch how much they come up with in reconciled savings. Savings that aren't reconciled--mandated to the authorizing committees--may never be realized. The Senate reconciles \$135 billion, the House only \$37 billion. And consider how defense comes out: the House denies even an inflation increase, which we allow. But the Senate, and the House Armed Services Committee, are working on defense authorizations that give the inflation adjustment. That tells me that the House defense number represents phoney savings--they won't be achieved, but they are plugged in the budget to avoid making real cuts in other programs.