

Ex. 258 J, Mtrls.

12/20/80 Court says special assessments exempt from Prop. 4

By BOB EGELKO

SACRAMENTO (AP) — Special assessments against property owners, an important means of financing such residential improvements as streets and sewers, are exempt from local governments' Gann spending limits, a state appeals court has ruled.

A unanimous three-member panel of the 3rd District Court of Appeal said the assessments, levied against owners to the extent their property gains value by the improvements, "are not taxes at all."

John Myers, a lawyer for Placer County Treasurer F. Earl Corin, nominal defendant in the suit, said yesterday he anticipates an appeal to the state Supreme Court.

The decision, issued Wednesday, involves an assessment proposed in April 1979 by Placer County supervisors in the

Tierra Heights Sewer Assessment District A-79, a small subdivision near Auburn.

The county had received a federal grant of \$55,000, covering half the cost of sewer construction, and planned to collect the remainder from homeowners in the subdivision by a special assessment.

Such assessments, used for more than 60 years to finance a wide variety of property-related services, are made by dividing the cost among property owners according to how much each parcel of land would benefit by the service.

Many homeowners defer payment, and the county issues bonds secured by the unpaid assessments. County Counsel L.J. Dewald said no bonds have been issued pending the outcome of the suit, which was tried initially in the appeals court.

The issue was whether special assess-

ments are covered by Prop. 4 of 1979, the state and local government spending limit initiative sponsored by Paul Gann.

That measure limits annual state and local spending to the previous year's spending plus the percentage increase in the cost of living plus population.

But the spending lid applies only to the "proceeds of taxes."

Justice Frances Newell Carr, who wrote the opinion, said Prop. 4 defined taxes as money raised for the support of government, and fees that exceeded the cost of the services they supported.

"Special or local assessments, on the other hand, are imposed on property within a limited area for payment of a local improvement allegedly enhancing the value of the property taxed," she wrote.

"Special assessments can be levied

only on the specific property benefited and not on all the property in a district."

She also noted that an earlier case, from Fresno County, had decided that special assessments were not taxes for the purpose of Prop. 13 of 1978, which requires new local taxes to be approved by two-thirds of the voters.

If special assessments were brought under the spending limit, Carr said, local governments would be faced with "limiting or discontinuing general improvements and services for the benefit of the many in order to provide a local area with special benefit improvements for the few."

She also said the \$55,000 federal grant was exempt from the spending limit, though payments to local governments from the state are counted in local spending limits.

British Columbia battles Ottawa

Associated Press

VANCOUVER, British Columbia — British Columbia is withholding federal natural gas excise taxes as part of the western provinces' running battle with Ottawa over who should control Canada's mineral wealth.

"We're taking this step in the national interests," the province's energy minister, Robert H. McClelland, said in announcing the decision Saturday. "Our energy future is seriously threatened."

Officials in Ottawa refused to comment on British Columbia's decision. A spokesman in Ottawa said the government would reply to Vancouver "once we've reviewed the entire text of the B.C. government's position."

The government of Prime Minister Pierre Elliott Trudeau imposed a federal excise tax on Nov. 1 of 30 cents per thousand cubic feet on all natural gas used in Canada as well as on propane, butane and other liquids derived from natural gas. British Columbia officials say their province's tax assessment amounts to \$158 million over three years.

McClelland said he had ordered two local natural gas companies not to pay the tax on domestic sales, which is aimed at increasing Ottawa's share of oil and gas revenues. He said the province's government also is considering withholding an excise tax to be applied beginning Feb. 1 on gas exports to the United States.

He claimed Canada's national energy program already has brought about a reduction in petroleum exploration in British Columbia and said a further slowdown in activity is expected.

It was the second direct challenge to federal energy pricing policies announced last November. Earlier this year the government of the western province of Alberta, Canada's major oil producer, announced it would unilaterally cut back oil production by 15 percent beginning March 1.

Saskatchewan Premier Allen Blakeney said last week that his government is seeking legal advice before making a decision on whether to pay the new tax.

British Columbia is taking a similar action next

month in its provincial court of appeal and is holding the tax money in trust pending a decision, officials said.

The three western provinces account for all of Canada's domestic oil and gas production. Their three premiers claim the federal government has no right to levy direct taxes on any provincially-owned resource. All three fought bitterly with the federal government earlier this year on drafting Canada's first constitution, which they want to see include protection of provincial mineral rights.

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The railway, as well as Solidarity and a state-backed for distributing pay raises

Both unions have accepted the overall sum, but Solidarity has demanded exclusive rights to bargain for railway workers. It claims to represent 85% of the railway force

Frasyniuk said the union had asked a prominent actor and member of Parliament, Gustaw Holoubek, to meet

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John Adams, "Midnight Judges," and oil

When John Adams lost the bitter presidential election of 1800 to Thomas Jefferson, he swept out of office in an unparalleled mood of pique. Inauguration took place on March 4 in those days, and on the night of March 3, 1801, President Adams appointed 58 judges to courts he helped create during his lame-duck tenure—the "midnight judges" of the history books. Adams also signed a law reducing the number of Supreme Court justices from six to five—this to deprive Jefferson of the opportunity to make an early appointment to the nation's highest court

Nearly 180 years later, President Carter promised that "We'll have a very fine transition period—I told him (President-elect Reagan) I wanted the best one in history." But not for the oil industry apparently.

Within a week after that promise, the Administration's Treasury Department issued new regulations which would reduce the tax credits American oil companies can apply against taxes paid to foreign countries on income earned abroad, and thus expose them to double taxation.

The new regulations—if they were to become law—would effectively repeal for the oil industry a protection against double taxation that has been a part of our tax system for all industries since 1918. The Administration has been campaigning to impose double taxation on the oil industry since it was inaugurated in 1977. It has pressed for punitive legislation, revoked rulings issued over the decades, and replaced them with unfavorable new rulings. In June, 1979, it proposed new regulations which developed in detail the philosophy of the latest unfavorable rulings. The 1979 proposals sparked controversy that has continued ever since.

For four years, Congress has refused to enact the punitive changes in the oil industry's foreign tax structure proposed by the Administration; since June, 1979, many voices, including some belonging to Congressmen, have claimed that the Treasury Department is trying to do by decree what Congress has refused to do by law.

We had thought that the flawed regulations would remain on the back burner until a new Administration

and a new Congress had had a chance to review the broader issue of tax policy generally. But that was not the case; in the spirit of the midnight judges, the Treasury Department, just 68 days before the current Administration leaves office, promulgated a set of regulations slightly different from the 1979 version. The end result, however, remains the same: loss of tax credit for foreign taxes paid on foreign income—double taxation for the oil industry.

What would double taxation mean?

Simply, that oil companies would be unable to compete overseas against companies from such nations as Great Britain, France, Germany, Japan, and the Netherlands, all of which would continue to receive foreign tax credits. In other words, America might very well have to buy its foreign oil from foreign firms.

How flawed are the new regulations? Try this Catch-22 situation:

If a foreign country imposes the same tax on the oil industry as it imposes on other industries, the tax paid by the oil industry is creditable. If, however, a foreign country imposes a higher income tax on oil companies than it does on other industries—and many oil-producing countries, such as Nigeria, do—then none of the tax paid by the industry is creditable against the U.S. taxes on income earned overseas. Instead, the whole tax is presumed to be a noncreditable expense. Under the new regulations, if a company pays more tax it is assumed that it paid no tax. We recognize the right of sovereign nations to tax individual industries as they see fit; even in the U.S., oil companies are taxed more heavily than other companies, if you add the burden of the windfall profits tax to normal income levies.

The result that would be achieved defies explanation—or is the answer that the new regulations are merely the final philosophical revelation of an Administration whose policies have consistently been to make it ultimately impossible for American oil companies to operate overseas—policies which, if not reversed, would do great damage to America's ability to maintain access to vital foreign oil supplies?

Facts about the foreign tax credit

(Editors please note)

1. Under the Internal Revenue Code, the foreign tax credit applies to all industries—not just the oil industry—and has been part of the U.S. tax law since 1918.
2. Other industrial nations give similar—or better—treatment to their companies.
3. Without the foreign tax credit, U.S. industries operating overseas would be at a competitive disadvantage. U.S. exports would diminish and the U.S. balances of payments would suffer.
4. The foreign tax credit is available to all U.S. companies operating abroad.
5. Foreign taxes cannot be credited against taxes on income earned in the U.S.
6. The foreign tax credit permits foreign income taxes to be offset only against U.S. taxes on income earned abroad.

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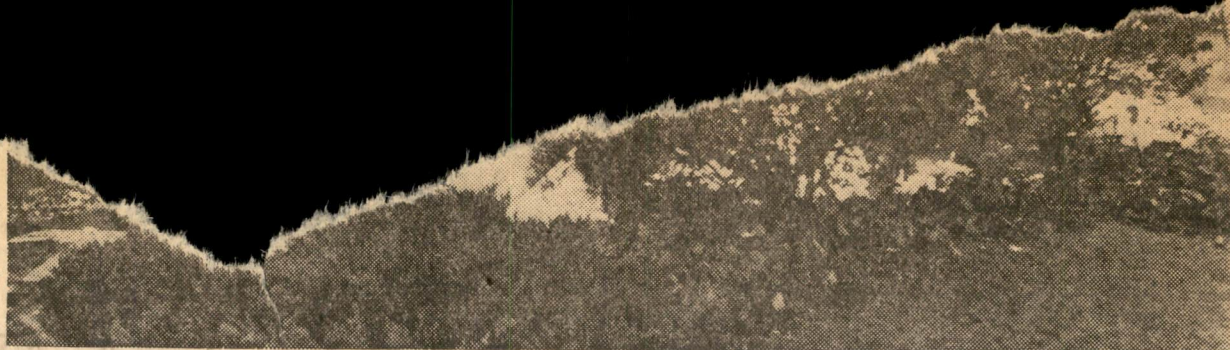
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KEN HIVELY / Los Angeles Times

Driven by high winds, flames sweep through a house on H Street in the San Bernardino fire area.

Chief's Advice

Things to Do in Fire Areas

Los Angeles County Fire Chief Clyde A. Bragdon Jr. had advice Monday for homeowners whose property might be threatened by the new epidemic of Southern California fires.

"Place combustible furniture and awnings in the garage," he said, "and move any woodpiles stacked next to buildings. Keep windows and doors closed to prevent embers from blowing into the house.

"Back the car into your garage—heading out—and disconnect the electric garage door opener. Seal off attic and eave vents."

If you wish to try to fight the fire yourself:

"Connect the garden hoses with nozzles at strategic outdoor faucets.

"But do not use water!

"Wet down your wooden roof only when the fire is within 600 feet. If a fire storm develops, go inside until it passes, then immediately check the roof and the attic for fire or embers.

please see **THREAT**, Page 25

Brown Claims Votes To Win Speakership

Bolstered by GOP, Berman Defectors, He Says He Has 51

By CLAUDIA LUTHER
and TRACY WOOD
Times Staff Writers

SACRAMENTO—Democratic Assemblyman Willie L. Brown Jr., bolstered by Republicans and new defectors from rival Howard L. Berman, said Monday that he has more than enough votes to elect him Speaker but said he still lacks a majority of his own party members.

Traditionally, the Speaker is elected by a majority of his own party. But Brown refused to commit himself to abide by the choice of most of the 47 Assembly Democrats.

Berman, who has sought for almost a year to win the speakership, insisted that Brown's claim to certain victory was premature. Berman said a Republican Democratic coalition speakership is "doomed to failure."

"There's still a week left. We'll see on Dec. 1," Berman told reporters shortly after Brown's announcement.

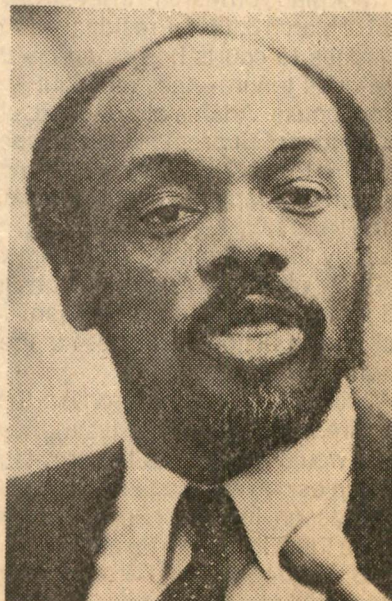
Dec. 1 is showdown day, the day that the Assembly organizes and elects a new speaker to succeed Leo T. McCarthy (D-San Francisco). Berman, McCarthy's challenger, and Brown, who jumped into the fray a week ago, have been seeking to solidify support before the vote by the full 80-member Assembly.

For Brown, a flamboyant, liberal black from San Francisco, the race is his second for Speaker. He was defeated in 1974 in a bitter contest with McCarthy.

10 More Votes Than Needed

After a closed-door meeting at a San Francisco airport hotel with McCarthy supporters, Brown raced to Sacramento for a press conference at the Capitol to announce his latest vote total. He said he has 51 votes—10 more than needed. He said he has backing from 23 Democrats and 28 Republicans.

Included in his list of supporters were four Berman allies who again changed their minds about who they would support. Brown claimed the new support of Richard Alatorre and Art Torres of Los Angeles, Wadie P. Deddeh of Chula



Los Angeles Times

Assemblyman Willie Brown

Vista and Bruce E. Young of Cerri-tos.

Each of the four had previously lined up behind McCarthy in his battle to stave off Berman. Later, they switched to Berman. Now, they back Brown. They gave no reasons for the switch.

Berman expressed surprise at the flip-flop but insisted he still has 24 Democratic supporters, a bare majority of Assembly Democrats. Berman said that, based on the looseness of support from at least Deddeh and Young over the last few months, he doubts how firm Brown's support is.

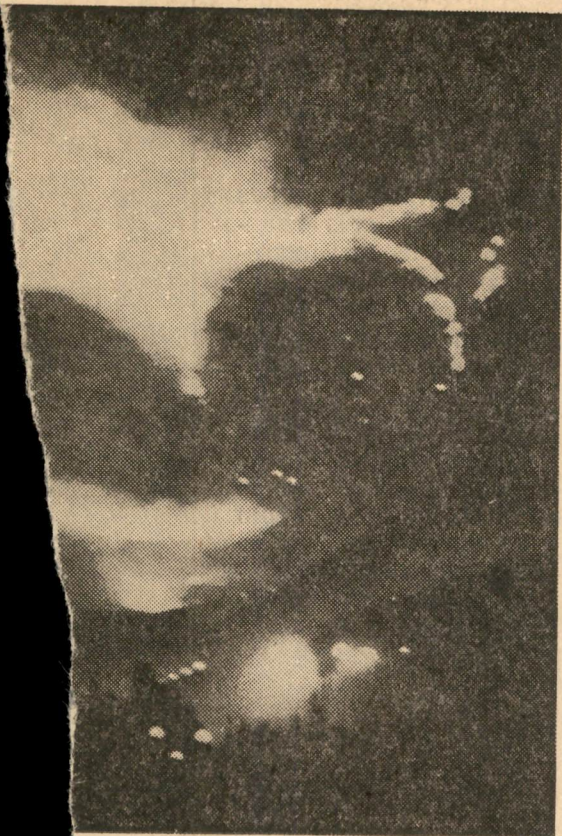
No Deals, He Insists

Brown insisted that no deals have been made to win Republican support but said he favors "reforming" the speakership to dilute some of the enormous power of the office. This has long been a Republican demand.

Brown said that he would be a "healing and unifying force" in the battered Assembly and that he would try to operate the lower house as he ran the Ways and Means Committee in the early 1970s.

This brought a shudder to some Capitol veterans, who said Brown was then regarded by his critics as a rude, argumentative tyrant. His supporters say he has "mellowed."

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MIKE MEADOWS / Los Angeles Times

San Bernardino; below, some street lights.

Dairy supports

Macro - also, Pub. Fin. + Ag. Econ.

Dairy program, govt. storage.

They don't throw the butter + cheese away,
but store it.

Cap needed :- for invy; also for warehouses.

In pub. fin., use this as an e.g. of govt.
spending, designed to w/h output from mkt.

Keynesian legacy. Ag. programs, whole idea
is to divert K from circ. to consumers, but
build up K for future - plus Ag K/O.

Some facts on dairying, LA Times, 3/23/81, p. 1.

Milk output per cow

1955 5,000 #/yr.

1980 20,000 " " by "some cows"

(Tech. here has saved K -- fewer cows needed.)

Result: fewer cows now than in '55.

1980, largest dairy surplus in 20 yrs.

8.2 G# milk diverted to storage, $\frac{1}{12}$ of the
yr's prodn. of 98 G#

2

Fed. cost of buying surplus to store.

1979 G\$ 0.4

1980 G\$ 1.3

1981 2.0 forecast

adds to fed. costs for food stamps.

Raises cons. price, costs cons. another \$1.5 b

Current law dates from 1949.

There were others before.

Cal. has its own. Cal. is #2 dairy state.

Support is at 80% parity, adj. 2 times a yr.
Now at 12.80/cwt, cheese quality milk.

Dairy lobby, one of U.S. 10 largest campaign
givers.

Storage is a subvt. for price flex. (cf. water.)

Half the support pmts. go to largest 15%
(but note regression fallacy. These are feeders.)

3
Consumers point to lower costs. but. of more milk per cow. (But this only cuts down cap. cost. Feed ~~to~~ conversion ratio is more impt. If cows eat 3 times more, there is no feed or land saving. It is like having fewer tree stumps, each spreading out more.

Write Purdue Exts. Extension Babb + Robt. Boynton, study of milk costs of prodn., '74-'79. Costs rose 16%; prices, 50%.

They probly. count no interest!
Storage + ~~handling~~ costs govt \$4.5 / day, or \$M 182 / yr. Some spoils.
Some given away.

Milk consumption declining.

Develop models, re storage cost. Show int. cost as fn. of turnover.

Public Face

3/29/81 Stockman concedes, his proposed welfare cuts wd. reduce work incentives. They reduce aid to working poor, more than to non-working.

A working mother receives these points:

A F D C

~~the~~ Tax credits

Food stamps

the Securities and Exchange Commission, will be handled by underwriters led by Goldman, Sachs & Co. The company, which recently had about 2.1 million common shares outstanding, will use proceeds to retire short-term borrowings and to provide funds for construction.

The 300,000 shares have a current market value of about \$7 million.

* * *

Frigitemp Note Placement

NEW YORK—Frigitemp Corp. said it arranged to sell privately \$8 million of 10½% senior promissory notes to Equitable Life Assurance Society of the U.S.

Of the total, \$3.5 million were sold yesterday and the rest will be sold in January, the interior-design concern said. Proceeds will be used to retire certain existing debt. Principal payments are to begin in 1979 and run through 1990.

* * *

Money Rates

NEW YORK — Bankers' acceptance offered rates quoted by one dealer: 30 days, 4.90%; 60 days, 4.90%; 90 days, 5%; 120 days, 5.10%; 150 days 5.15%, 180 days, 5.20%.

Federal funds in an open market: day's high 5.1-16%, low 4.15-16%; closing bid 5%, offered 5¼%.

Prime lending rate at large New York banks: 6¼%.

Call money lent brokers on stock exchange collateral: 5¼% to 6¼%.

Commercial paper placed directly by a major finance company: 30 to 59 days, 4¼%; 60 to 89 days, 4¼%; 90 to 270 days, 5%.

Commercial paper sold through dealers: 30 to 270 days, 4¾% to 5¼%.

Certificates of deposit (\$100,000 or more): top rates paid by major banks in the newly issued market, one month 4.85%; two months, 4.90%; three months, 5%; six months, 5.25%; one year, 5¼%.

Eurodollar rates in London include: one month, 4.15-16% to 4¾%; two months, 5.5-16% to 5¼%; three months, 5.7-16% to 5¾%; four months, 5.9-16% to 5½%; five months, 5¼% to 5.11-16%; six months, 5.13-16% to 5¼%.

Rates shown are only a guideline to general trends, and don't necessarily represent actual transactions.

Tax-Exempt Bonds

Here are current prices of several active tax-exempt revenue bonds issued by toll roads and other public authorities.

Agency	Coupon	Mat	Bid	Asked	Chg.
Bat Pk City Auth NY	6¼s	'14	65½	69½	+1
Chi Calumet Skyway-f	3¼s	'95	51	53	
Chelan Dist	5s	'13	86½	88½	1/2
Chesapeake B Br&Tun-f	5¼s	'00	63½	67½	
Chgo-O'Hare Int Airt	4¼s	'99	94	96	1/2
Dallas-Ft Worth Airt	6¼s	'02	93½	96½	1/2
Delaware Riv Port Auth	6½s	'11	93	95	
Delaware Riv Port Auth	6s	'10	88½	90½	
Douglas Cnty PU Dist	4s	'18	70½	72½	1/2
Florida Turnpike	4¼s	'01	87	89	
Gr'tr New Orl Expr	4.9s	'06	81½	83½	1/2
Illinois Toll	3¼s	'95	85½	87½	
Indiana Toll	3½s	'94	84½	86½	1/2
Kentucky Turnpike	6¼s	'08	94	96	
Maine Turnpike	4s	'89	99	102	
Maryland Br&Tun	5.2s	'08	89½	91½	
Massachusetts Turnpike	3.3s	'94	83½	85½	1/2
Munic. Assist. Co. NY	8s	'86	81½	84½	1/2
Munic. Assist. Co. NY	8s	'91	78½	81½	1/2
Munic. Assist. Co. NY	9s	'85	91½	93½	1/2
Munic. Assist. Co. NY	9¼s	'90	91½	93½	1/2
Munic. Assist. Co. NY	11s	'83	103½	105½	1/2
NJ Turnpike Auth	5.7s	'13	90	92	1/2
NJ Turnpike	7s	'09	109½	111½	
NJ Sports & Expos	7½s	'09	93	96	
NY State Power Auth	5¼s	'10	86½	89½	
NY State Thruway	3.1s	'94	64	66	-1
NY State Urban Develop	7s	'14	69½	72½	
Ohio Turnpike	3¼s	'92	98½	100½	
Penn Turnpike	3.1s	'93	81	83	
Port of NY Auth	8.2s	'11	108½	110½	1/2
Port of NY Auth	5½s	'08	79½	82½	1/2
Port of NY Auth	6s	'08	87½	90½	1/2
Richmond-Met Auth	5.6s	'13	85½	89½	
West Virginia Turnpike-f	3¼s	'89	76	80	-1

f-Trades flat without payment of current interest.

Tax-Exempts

Exxon Confirms Offer Of \$55 Million of Bonds By Direct Public Sale

By a WALL STREET JOURNAL Staff Reporter

NEW YORK—Exxon Corp. acknowledged plans for a \$55 million "Dutch" auction of tax-exempt revenue bonds in what is believed to be the first direct public sale by any corporation ever.

The bonds are to be issued by the Gulf Coast Waste Disposal Authority to finance pollution-control facilities for Exxon plants at Houston and Baytown, Texas. Interest and principal payments on the 30-year bonds are to be guaranteed by the giant oil concern.

Under the proposed auction, which sources had divulged earlier this week, all bonds are awarded at a uniform price, determined by the highest acceptable yield. In the past, Exxon like other corporations, has offered its securities through underwriters. Indeed, Morgan Stanley & Co., long the managing underwriter for Exxon offerings, lost no time in assembling a group of Wall Street investment bankers for possible bidding on this issue. Exxon's far-reaching sales plan clearly has disturbed several major underwriting firms, who see their proprietary relationships threatened.

Jack Bennett, an Exxon senior vice president and a former Under Secretary of the Treasury for monetary affairs, said: "We regard this (auction method) as an experiment to provide us experience on whether to apply the same technique" on possible larger Exxon offerings.

The Texas authority has issued an invitation to investors, broker-dealers and others to submit purchase orders. Bids must be submitted on a yield basis for a minimum of \$100,000. They will be received until 5 p.m. (New York time), Nov. 16, at Morgan Guaranty Trust Co. of New York or in Houston at Texas Commerce Bank National Association, co-fiscal agents.

* * *

Pennsylvania County Unit Awards \$25,615,000 of Bonds

NEW YORK—Washington School Authority, Washington County, Pa., awarded \$25,615,000 of refunding and school building revenue bonds to Arthurs, Lestrangle & Short and associates.

The sale involves \$14,605,000 of serial refunding obligations, set to return 2.9% in 1977 to 5% in 1986, and \$11,010,000 of building revenue securities.

Of the revenue total, \$2,125,000 of bonds are due in 1996 with 6.25% interest coupons, \$2,245,000 are due in 2000 and carry 6.375% coupons and \$2.9 million of securities due in 2004 have 6.5% coupons. All the term bonds

are priced at 100. The remaining \$3,740,000 of revenue obligations are scaled to return 3% in 1977 to 5.95% in 1991.

A spokesman for the underwriters said the overall unsold balance late yesterday totaled about \$5.1 million.

* * *

Minnesota Housing Unit's \$33 Million Issue Is Awarded

NEW YORK — Minnesota Housing Finance Agency's \$33 million of short-term housing-development bond anticipation notes were awarded to an Allison-Williams Co.-led team.

The underwriters' winning bid placed the interest cost to the agency at 4.29%.

A reoffering yield of 4% left about \$17 million of securities remaining to be sold late yesterday.

* * *

Salix, Iowa, \$18 Million Issue

NEW YORK—Salix, Iowa, issued \$18 million of revenue bonds to finance pollution-control facilities for Iowa Public Service Co.

Rated double-A by Standard & Poor's, the 30-year 6¼% bonds are being offered publicly at a price of 100 through underwriters led by Blyth Eastman Dillon & Co. and Carleton D. Beh Co.

* * *

Sales

Babylon, N.Y. accepted a bid of 100.052 for 7% interest coupons and awarded \$13,712,550 of various purpose bonds to a team led by Chase Manhattan Bank. The obligations are rated single-A by Moody's and are scaled to return 4.3% in 1977 to 7.2% in 2000. Late yesterday, around \$5.4 million of securities was still available to investors.

New Orleans, La., apparently agreed to a yearly interest charge of 5.908% and awarded \$6 million of International Airport revenue bonds to Bache Halsey Stuart Inc. and associates. Reoffering yields, ranging from 3.9% in 1979 to 6.25% in 1996, produced an unsold balance late yesterday of about \$5.5 million. The bonds are rated single-A.

TVA Sets Early Redemption Of \$150 Million in Bonds

KNOXVILLE—The Tennessee Valley Authority announced plans for the early redemption of its \$100 million in 9% bonds and its \$50 million in 9¼% bonds, all due in 1995.

The redemption date will be Dec. 15. All of the bonds will be called at a price of \$1,063 for every \$1,000 face amount, with an additional \$22.50 in accrued interest to be paid on the 9% bonds.

Business Failures in Week

NEW YORK—Commercial and industrial failures rose to 174 in the week ended Oct. 21 from 134 in the preceding holiday week but fell from 195 in the year-earlier week, Dun & Bradstreet Inc. said.

Pub. Face + factor program.

Housing in Cal. + in City of L.A. +
City of L.A. grew at 2x pop. rate, 1970-80
LA Times, 4/7/81, citing Census.

Cal. pop. Δ 18.5% 1970-80
d.u. Δ 32.6%

LA City, pop. Δ 6.2%
d.u. Δ 12.4%

LA City, pop. Δ 5.5%
d.u. Δ 10.7%

Orange City, pop. Δ 35.9%
d.u. Δ 55.7%

Housing uses much land + capt. Reduce prop. tax,
etc., people use more.

Crime rate. More people living separately
means more crime.

Tax Depreciation:

Analysis and Policy

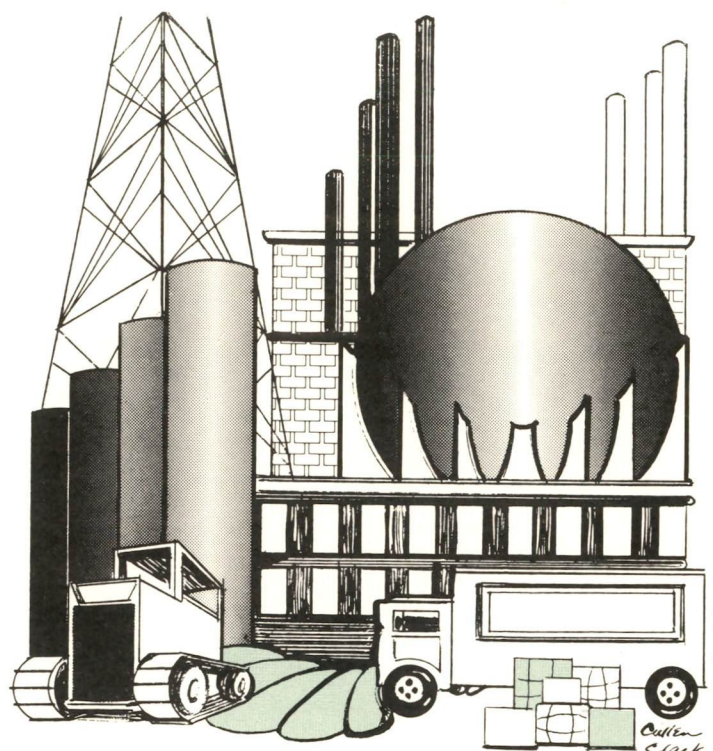
Tax depreciation is one of the key policy issues facing the Reagan administration. Inflation and the desire to provide ready capital for investment contribute to the timeliness and urgency of the depreciation proposals currently before Congress.

Tax depreciation policy has changed many times in the last thirty years. Prior to 1954, taxpayers could depreciate their assets in equal increments over a period of time specified by the Internal Revenue Service. This method ("straight-line depreciation") was augmented in 1954 by depreciation patterns in which a larger portion of the total depreciation allowance was taken in the early years of asset life ("accelerated depreciation"). In 1962 and 1971, the periods over which depreciation allowances were spread were shortened and made more industry-specific. In all cases, depreciation allowances were intended ultimately to reflect in an overall sense the capital consumption actually experienced by taxpayers (through such devices as the Reserve Ratio Test).

Other major efforts to reform depreciation policy were made in 1980. In order to increase capital formation and enhance productivity growth, U.S. Representatives Barber B. Conable, Jr., and James R. Jones proposed a further liberalization of depreciation allowances. Their 10-5-3 system allows accelerated depreciation over a ten-year period for structures, over a five-year period for machinery and equipment, and over a three-year period for automobiles and light trucks. This proposal was followed by the Senate Finance Committee's 2-4-7-10 plan, a proposal by economists Alan Auerbach and Dale W. Jorgenson to substitute a first-year recovery allowance for depreciation, and modifications of the Conable-Jones and Senate Finance Committee accelerated write-offs proposals by both the Carter and Reagan administrations.

The Urban Institute hosted a conference on December 1, 1980, to discuss current tax depreciation policy alternatives (see box below for participants). The proceedings of the conference will be published by The Urban Institute in the summer of 1981.

In the question-and-answer sequence below, Charles R. Hulten, a senior research associate at The Urban Institute, convenor of the conference, and editor of its proceedings, discusses issues examined by the conference and gives his views on tax depreciation alternatives. These statements reflect his own views and should not be attributed to the Institute or to any individual conferee.



How are depreciation allowances treated under the current tax code?

HULTEN: Under the current tax code, taxpayers have the option of depreciating their equipment under the Asset Depreciation Range system (ADR), or of using their actual facts and circumstances to justify another tax life in computing their deductions. The taxpayer who elects the ADR system selects a tax life from the ADR range and depreciates the original or historical cost of the asset using either the straight-line form, the sum-of-the-years'-digits form, or the appropriate declining balance form.

Taxpayers are also eligible for an investment tax credit for most types of equipment, the size of which depends on the tax life selected in the ADR range: 10 percent for equipment with a life of seven years or more, 6⅔ percent for a life of five to seven years, 3⅓ percent for a life of three to five years, and no credit for a life less than three years. Because the selection of a tax life conditions the amount of tax credit available, the shortest possible life in the ADR range is not always the most advantageous life to select.

Structures were not included in ADR and are thus nominally subject to the lives prescribed in the 1962 guidelines. However, a 1971 Treasury Department survey indicated that most taxpayers were claiming shorter tax lives than those prescribed by the guidelines.

CONFERENCE PAPERS AND PARTICIPANTS

Introduction

Emil Sunley, Deputy Assistant Secretary for Tax Policy,
U.S. Department of the Treasury

Concepts of Capital, Income, and Depreciation

Chair: Professor Peter Mieszkowski,
University of Houston

Paper: Professor Robert E. Hall,
Stanford University

Discussants: Professor W. Erwin Diewert,
The University of British Columbia

Professor John W. Kendrick,
George Washington University

The Measurement of Capital and Depreciation

Chair: Professor Robert Eisner,
Northwestern University

Paper: Charles R. Hulten, Senior Research
Associate, The Urban Institute

Professor Frank C. Wykoff,
Pomona College

Discussants: Frank DeLeeuw, Chief Statistician,
Bureau of Economic Analysis,
U.S. Department of Commerce

Professor Paul J. Taubman,
University of Pennsylvania

Criteria for Evaluating Depreciation Policies

Chair: Rudy Penner, Resident Scholar,
The American Enterprise Institute

Paper: Professor David Bradford,
Princeton University

Discussants: Professor Thomas Dernberg,
American University

Professor Dale W. Jorgenson,
Harvard University

Roundtable on Policy Initiatives to Stimulate Productivity

Chair: Professor E. Cary Brown,
Massachusetts Institute of Technology

Participants: Bruce Davie, Ways and Means Committee,
U.S. House of Representatives

Professor Robert Eisner,
Northwestern University

Professor Dale W. Jorgenson,
Harvard University

Emil Sunley, Deputy Assistant Secretary
for Tax Policy, U.S. Department of the
Treasury

James Wetzler, Joint Committee on
Taxation, U.S. Congress

Judging by recent press accounts, the current treatment of depreciation is widely viewed as unsatisfactory. Why?

HULTEN: The fact that depreciation deductions are limited to the original cost of an asset became a major problem during the high inflation period of the 1970s. As the price level rose, the real value of original cost depreciation deductions fell, and effective tax rates were thereby increased. This inflation-induced rise in effective tax rates on capital income reduced the incentive to invest and is therefore widely believed to have been a contributing factor to the highly publicized productivity slowdown of the 1970s.

In addition, the tax code is generally perceived as being far too complicated. There are, for example, 130 separate ADR classes. One objective of the current effort at tax reform is to simplify the tax code.

However, even without the issues of historical cost depreciation and tax code simplification, there would probably be a strong effort to alter the current system. Capital formation is widely perceived as inadequate, and depreciation allowances have traditionally been viewed as a policy mechanism for stimulating capital formation. The basic idea here is that the present value of depreciation deductions can be increased by allowing taxpayers to claim their deductions at an earlier date, even though the total amount of the deduction remains the same. The increased value of these accelerated allowances raises the rate of return to capital, thereby increasing the incentive to invest in plant and equipment.

The Reagan administration recently announced a plan to change the depreciation laws. What is the nature of this proposal, and how would it correct the perceived deficiencies of the current system?

HULTEN: The Reagan administration proposal is essentially an expanded version of the Conable-Jones proposal. Assets would be grouped into five categories—autos and light trucks; other machinery and equipment; factories, warehouses, and retail stores; other nonresidential structures; and residential structures—and given tax lives of three, five, ten, fifteen, and eighteen years respectively. A separate depreciation method would be given each of the five asset classes, and the rate of investment tax credit would be increased to 6 percent for the three-year assets and to 10 percent for the five-year assets. Other provisions of the current code would be altered as well, but these are the main features.

This proposal would move tax simplification forward by reducing the number of depreciation classes from 130 (under ADR) to 5 and simplifying other features of the code, such as the number of elective options available to taxpayers. The write-off periods for both plant and equipment would also be shortened considerably. Under current law, 80 percent of

the equipment classes have a minimum lifetime greater than five years, and most structures have tax lives greater than twenty-five years. The Reagan proposal would thus have the effect of accelerating depreciation allowances, and would therefore help compensate for the inroads made by inflation because of the historical cost problem. The accelerated allowances would also raise the rate of return to capital, and thus provide additional investment incentives.

What are the generally acknowledged concerns about this proposal?

HULTEN: These new tax lives are administratively determined and not subject to revision in light of actual taxpayer experience. Thus, even if these tax lives are appropriate for the current high levels of inflation, they will in general not approximate true capital consumption cost at low inflation rates. My own research indicates that if we succeed in driving inflation back to the 4 to 5 percent level, the new system will lead to negative effective tax rates on nonresidential business capital. In other words, at low rates of inflation, the value of deductions is greater than it is under a system that jettisons the various deductions and credits and allows investment to be written off immediately like a wage cost.

Furthermore, by breaking the link with actual experience, the proposed system will be vulnerable to lobbying efforts for still shorter tax lives. If 18-15-10-5-3 is good, why not 17-14-9-4-2 or something else? This point is not entirely academic, since the recent proposal to create enterprise zones in economically distressed cities would create a three-year depreciable life for plant and equipment. Such proposals, if implemented, could create a serious distortion in investment incentives.

Your own research has focused on the measurement of depreciation. Are there any specific policy directions implied by what you've found?

HULTEN: Yes. I believe that the soundest long-run depreciation policy is to maintain a link between tax deductions and real taxpayer experience. My own research has shown that economic depreciation cost can be measured, giving support to the view that tax and economic depreciation can be linked.

One implication of this link is that taxpayers must be compensated for the effect of inflation. If tax allowances are to be based on economic depreciation, the taxpayer must be allowed to increase his allowances when inflation causes his depreciation costs to increase. One way to accomplish this is to index depreciation allowances to the rate of inflation. Another way is to follow the proposal made by Alan Auerbach and Dale W. Jorgenson of Harvard University. Under this proposal, the taxpayers would recover their total depreciation allowances in the first

year of ownership. The amount of the deduction is equal to the present value of economic depreciation, adjusted to allow for inflation by capitalizing the true depreciation costs at a real rate of return of 4 percent.

The Auerbach-Jorgenson or indexing approach would solve the problem of historical cost depreciation and would stimulate capital formation at high rates of inflation. Additional stimulation would be obtained by a combination of tax credits or corporate tax rate reductions. Alternatively, capital formation could be stimulated by a system in which a part of an asset's value could be depreciated according to economic depreciation, and part by immediate write-off.

In your opinion, is there sufficient concern with the 10-5-3 system for Congress to examine these alternative proposals more closely?

HULTEN: I think so. It is important to realize that the 10-5-3 system is really geared to the very high inflation rates of the last few years. The generous provisions of 10-5-3 may be rationalized as an offset to the inflation-induced rise in effective tax rates due to historical cost depreciation. But what if the administration's monetary and fiscal policies succeed in reducing the rate of inflation? The inflation-induced offset would no longer be necessary for new plant and equipment, and the generous provisions of 10-5-3 would result in negative effective tax rates. This means that owners of plant and equipment would be able to shelter revenue from other sources. In this case, the 10-5-3 plan would be a system of subsidies rather than taxes.

Annual Report

The Urban Institute's 1980 annual report is now available. Persons wishing to receive the report should write the Institute's Public Affairs Office or call 202/223-1950, ext. 254.

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Commentary

By Lewis B. Beman

The Democrats go over to the supply side

In a year that has consistently defied conventional wisdom about the economic positions of political parties, perhaps the most amazing switch of all is the Democratic sponsorship of an immediate cut in the top marginal rate on investment income to 50% from 70%. It was, ironically, a proposal that President Reagan had rejected in February when aides convinced him that it would be politically damaging so obviously to "do something for the rich" while he was slashing social programs right and left.

But in March, Representative William M. Brodhead (D-Mich.), head of the liberal Democratic Study Group, called the top rate on unearned income "confiscatory" and introduced a bill to roll it back to the maximum now applicable to earned income. And in April, House Ways & Means Committee Chairman Dan Rostenkowski (D-Ill.) adopted the idea as part of his alternative to the Administration's tax package.

Liberal endorsement of a \$5 billion tax cut for the richest 1% of taxpayers represents "the ultimate victory of supply-side economics," says John M. Albertine, president of the American Business Conference, a new Washington-based lobbying group oriented toward entrepreneurs. A former executive director of the Joint Economic Committee who helped turn that bastion of congressional Keynesianism into a bipartisan advocate of the supply-side approach, Albertine sees the Brodhead bill as "the culmination of the effort that got under way five years ago to change the direction of tax policy from income redistribution to growth."

Away from tax shelters. In introducing his bill, Brodhead used an argument that Democrats once ridiculed as "free-lunch economics." The rate cut would lead to only a "paper" reduction in receipts, he said, since "much of this amount would be offset by increased tax revenues from the rechanneling of funds away from tax shelters and toward economically sound investments." And he cited Treasury estimates that the actual loss would be only \$200 million in the first year and that receipts would actually increase in succeeding years. "I couldn't have put it better myself," says Arthur B. Laffer, professor of economics at the University of Southern California, whose now-famous Laffer curve suggested that lower tax rates could lead to higher tax revenues.

But it would be unfortunate if Demo-

crats come to support a 30% tax cut for the rich only because they now believe that the Laffer curve actually works in the higher latitudes. For the real lesson of supply-side economics is that the interaction of inflation and a progressive income tax system is creating enormous distortions that the conventional framework of economic policy has tended to ignore. And in this regard, the rich are different mainly because of their ability to protect themselves through tax shelters.

The underlying problem, as defined by supply-siders, is that in a highly inflationary environment, a tax on investment income is literally "confiscatory." An increase in the price level erodes the real value of financial assets. Investors are, with luck, compensated by higher interest payments. But at a 70% tax rate, even those who received 15% on their money last year suffered a real capital loss of more than 8%. Or, putting it another way, real income from capital was taxed at a rate of more than 400%.

A Democratic dilemma. It is not difficult to see how such a situation would have a serious impact on the pattern of savings and investment. But it may well be that the "bracket creep" that affects mainly the middle-income groups is having effects that are even more serious in the aggregate. Someone who was earning \$20,000 in 1970 and has just kept pace with inflation has already seen his marginal income tax rate rise from 25% to 37%. If he managed to stay even with the conventional forecast of inflation, he will face a marginal rate of 49% by 1984 under the current law. That, of course, will make him the near-equal of the Rockefellers and the Mellons if the top rate on investment income is cut back to 50%. And it is not particularly far-fetched to think that his productivity and willingness to work may have deteriorated as each year brings a bigger cut in real disposable income.

No one expects the middle-income rates to remain where they are, particularly if the top rates come down. But while the Democrats have announced that the bulk of their own package will be aimed at tax relief for those now earning \$20,000 to \$50,000, they have a serious dilemma. Preventing their taxes from actually increasing over the next four years will take rate cuts almost identical to those of the Reagan tax plan, which they still oppose as a matter of principle and partisan politics.

Assn. (NGA), these revenue losses would amount to 3% of corporate receipts by states this year and more than 27% in 1986. Nearly all states with a corporate income tax now follow federal depreciation guidelines, and in more than half those states, federal rules are incorporated automatically into state tax codes. Counting the District of Columbia, 43 jurisdictions have linked their corporate taxes, or at least depreciation, to the federal tax code, just as many states with personal income taxes "piggyback" on the federal system. Thus, when Washington changes its tax rules, state taxes tend to change in the same direction. "That's the cost of piggybacking," says an Administration official.

An unavoidable loss. State officials clearly are aware of the possible "double whammy" effect of the proposed federal spending and tax cuts. Says Joseph McLaughlin, director of public affairs for the NGA: "The governors are all for investment-incentive tax changes. But without knowing the final form of the package that will emerge from Congress, there will be no time for the states to adjust this year, particularly with the depreciation revision to be made retroactive to Jan. 1, 1981."

McLaughlin considers the potential loss of \$500 million this year "unavoid-

The proposed tax rules will slash state as well as federal revenues

able," although the legislatures could start acting next fall to reduce the projected loss of \$1.6 billion for 1982, and they could head off the \$8.8 billion revenue drop foreseen for 1986 by rewriting their tax rules and regulations. McLaughlin notes, however, that some states "consider it unthinkable to give up the advantages of simplification and ease of enforcement gained through piggybacking."

Fierce competition. One option for the states will be to increase their own corporate tax rates to offset the depreciation change. But that would not recoup their losses entirely, because the Reagan version of 10-5-3 would eliminate taxable income for many companies with heavy investment write-offs. Some states indicate that they will go along with the federal change in whole or in part, but McLaughlin and other public finance experts in Washington fear that the resultant disparity in the way states tax corporate income would exacerbate the fierce competition to attract industry. "Of course, the states could simply tell companies to keep using the 1980 federal tax rules as the basis for computing their 1981 state taxes," says a congressional tax aide. "Then they can sit back and listen to the screams." ■



John Shannon

But now the Administration proposes to chop \$14.5 billion from federal funds flowing to state and local governments in fiscal 1982. This would start a cycle that would bring an absolute drop in federal dollars of 4% by 1984 or, if inflation is taken into account, a real decline of 30%, according to Alice Rivlin, director of the Congressional Budget Office. In addition, Congress last year eliminated the states' \$2.3 billion share of general revenue sharing funds, the full impact of which will hit in the states' next fiscal year. Partly to offset the force of domestic program cuts on the states, the

already under way as states and localities curtail spending. In 1949 state and local spending, including federal grants and aid, was 7.8% of the gross national product; it ballooned to 15.1% by 1975—twice as fast as the economy grew—but fell to an estimated 13.5% in 1980, according to the Advisory Commission on Intergovernmental Relations. "The Reagan cutbacks will accelerate the trend," says ACIR Assistant Director John Shannon. "There will be a somewhat leaner domestic public sector."

Until now, many states have been able to live comfortably from accumulated surpluses and rising federal aid, which reached \$95.6 billion in the current fiscal year. Many states, such as New York, got inflation-sparked jolts from income taxes while others, such as Texas, benefit from soaring income from taxes on energy sources. State and local tax receipts peaked in 1976 at 15.6% of GNP, and they declined only slightly to 14.65% by 1980, according to Chase Econometrics Inc.

Administration has proposed consolidating them into eight block grants and giving states freedom to use the funds within those large categories—such as education or health services—as they see fit.

Figuring the future. Understandably, these proposed changes in both the size and organization of federal aid—and their uncertain fate—leave governors and legislators baffled in budget deliberations. Some states with biennial sessions, such as Washington, are already considering giving up and coming back in a normally off year, and special sessions are likely in others.

The squeeze on revenues and worry about a bigger crunch next year have already revived consideration of tax increases by states and localities, albeit modest ones. Increases in motor fuel taxes are common—24 states have enacted or are considering them this year—and Illinois has proposed a 5% tax on gross receipts from sales of oil products that would yield as much as \$600 million.

In hard-pressed Ohio, which last December attempted to close a projected \$496 million budget deficit for this fiscal year with a temporary increase in taxes, legislators foresee a possible sales or income tax increase in the next couple of years. "Even after a great deal of travail and bloodletting," says W. Bennett Rose, Republican assistant minority leader of Ohio's House of Representatives, "you're going to see state and local tax increases."

The states, however, face far more for-

midable hurdles now to assuming added tax burdens. Citizen rebellion against property taxes has led 18 states so far to enact some form of tax or spending limit. The property tax revolt has caused states to absorb many local government costs and functions, paying for them from taxes on sales and personal and corporate income.

Worst problems. The squeeze is particularly acute in states, such as Michigan and Massachusetts, which are still in the throes of relieving property taxes while facing federal cutbacks and major urban financing problems. Michigan is also facing a crunching economic recession. Governor William G. Milliken is trying to get the voters to raise the state sales tax to 5.5% from 4% to finance property-tax relief, but this would still leave his state with a \$250 million shortfall, and cuts appear inevitable. Yet bad as this is, Michigan is also facing the loss of some \$150 million to \$250 million a year in federal funds.

Many major cities in the Midwest and Northeast face immediate problems from reductions in Comprehensive Employment & Training Act programs—which have already begun—and mass transit subsidies to be felt soon. In Boston and Philadelphia, tax and fee increases have been proposed, and Detroit is seeking big increases in its income tax.

The prevailing mood, however, remains one of fiscal austerity. "I'd be very much surprised to see any governor asking for tax increases to offset the loss of federal funds," says Shannon of the ACIR. "It would be like spitting into a gale. The days of constant state tax increases are gone for the next four or five years."

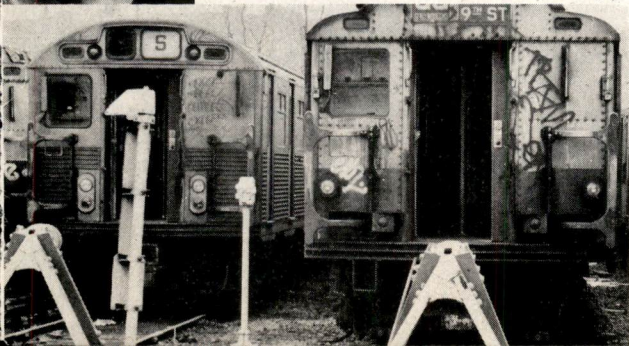
The 'double whammy' in faster write-offs

While state governments are scrambling to adjust to President Reagan's proposed budget cuts, most of them will also have to deal with a potentially severe jolt to their fiscal health from the Administration's tax program. The President proposes to speed up depreciation write-offs for new buildings and capital equipment, a variant of the so-called 10-5-3 plan. This would automatically slash the corporate income tax collections of any state that follows federal depreciation rules. Nationwide, the state revenue loss could hit \$500 million in 1981 and rise to \$8.8 billion in 1986.

According to the National Governors'



Patrick D. Pagnano



In the vise: Legislatures—at work is the Michigan Senate—face funding cutbacks for such programs as CETA (above) and mass transit (left). Many states will raise taxes at the gas pump to help fill the gap, but voters are resisting more income and sales levies.

Tax Avoider - Interest-free loans.

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partners. But from a tax point of view, the difference can be significant.

When the agreement specifies that the partnership is to buy out the interest of a retiring or deceased partner, this constitutes a "liquidation" of his interest. (See Section 736) A liquidation entitles the continuing partners to write off their buy-out payments to the extent they exceed the value of the departing partner's interest in the property. It also requires the retiring partner or his estate to report the excess payments as ordinary income. Consequently, a liquidation favors the continuing partners.

Assume instead that the agreement calls for the remaining partners, as *individuals*, to buy out his interest. Then the acquiring partners get no deduction for their buy-out payments. But the outgoing partner (or his estate) gets capital gain (as opposed to ordinary income) treatment for those payments, except as to portions attributable to unrealized receivables and appreciated inventory. Accordingly, a sale to the partners favors the outgoing partner.

To avoid the trouble and cost of a tax dispute, the agreement should spell out whether the method selected is a liq-

uidation or a sale. Once it has been determined which route to go, the amount due an outgoing partner can be adjusted to take account of the income tax consequences.

For example, where the parties, whether by design or inadvertence, failed to clearly specify the nature of the transaction, the Tax Court held that the agreement in issue was for a liquidation. It used the words "partnership" or "continuing partnership" to designate the remaining partners. Thus, the agreement did not, in any way, evidence an intention on the part of the retiring partner to sell his partnership interest to the remaining partners as individuals. (Champlin, TC Memo. 1977-196)

RIA OBSERVATION:

Even when everyone agrees to a liquidation, the way the agreement is worded can affect the tax results. For instance, any portion of the payment which is specifically allocated to goodwill by the agreement will be taxed as a capital gain (rather than ordinary income) to the outgoing partner, and the partnership gets no deduction.

Interest-free loans to shareholders and executives

✓ **A**t many companies, the executive compensation package includes interest-free or low-interest loans. The IRS has repeatedly taken the position that executives who receive such loans also receive additional income equal to the amount of interest that might have been charged.

! ✓ Although this view has been rejected by the Tax Court and the Fourth Cir-

cuit, the IRS has persisted in its attempts to exact taxes from executives on the value of these loans.

In one case, the Tax Court stated that if income were to be attributed to a taxpayer because he received an interest-free or low-interest loan, he would also be entitled to an equal offsetting deduction for interest paid. (*Dean*, 35 TC 1083) But in another case, the court suggested that if the indebtedness was incurred by the executive to purchase

or carry tax-exempt bonds, a different result might be reached since Code Sec. 265 disallows a deduction for interest paid in respect of such indebtedness. (Zager, 72 TC 1009)

The IRS tried unsuccessfully to raise this issue in a new case. Jack Baker, the president of a family corporation, maintained a running (interest-free) loan account with the corporation. During the three years at issue, his average loan balance was \$37,000, \$96,000 and \$53,000 respectively. In each of those years, Baker invested \$45,000 in tax-exempts. During the period, his tax-exempt portfolio grew from \$129,000 to \$245,000.

The IRS argued that Baker's indebtedness was incurred to carry or purchase the tax-exempts, and consequently any interest paid on such indebtedness would not be deductible. But the Tax Court noted that Baker and the IRS had stipulated that the funds borrowed were used to make estimated tax payments. Moreover, there was no evidence of a correlation between the

loans and tax-exempt investments. (Baker, 75 TC No. 11)

R RIA CAUTION:

There is also the question of whether the "loan" is a loan at all. A stockholder may borrow money from his corporation with or without interest, and with or without security.

Whatever the legality of such transactions under the law of your state, for tax purposes, if the agreement and bona fide intention are that the amount be repaid to the corporation, and if there is persuasive evidence of the intention and ability to carry it out, the amount received is treated as

what it purports to be, a (nontaxable) loan, not a (taxable) dividend. This evidence may be lacking, notes the Tenth Circuit, where the shareholder goes too far, producing, via "loans," an "excessive and continuous diversion of corporate funds into the controlling shareholder's pocket." (Dolese, 605 F.2d 146)

Odds favor IRS on disputes that wind up in court

If an Internal Revenue agent insists on some extra taxes and you disagree with his or her findings, you can go higher in the hierarchy. And if your appeals get you exactly nowhere, you can have your dispute heard by a judge.

But the Revenue Service's statistics reveal that taxpayers fare poorly when they go beyond the IRS itself and try their luck with the courts. To the right is the taxpayers' scorecard for fiscal 1980:

	Partial Victory	Complete Victory	Lost
Tax Court			
Small tax cases*	37.1%	9.5%	53.4%
Regular tax cases	38.0%	11.0%	51.0%
District Court	11.8%	22.4%	65.8%
Court of Claims	6.0%	48.0%	46.0%

*generally under \$1,500, but the figure was increased to \$5,000 on June 1, 1979.

R RIA OBSERVATION:

Although you can turn to the Tax Court without paying any money, you must first pay the tax to get into a district court or the Court of Claims.