IMPACT OF TAX LAW ON LAND USE

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDRED FOURTH CONGRESS

SECOND SESSION

JULY 16, 1996

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IMPACT OF TAX LAW ON LAND USE

TUESDAY, JULY 16, 1996

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON OVERSIGHT,
Washington, DC.

The Subcommittee met, pursuant to call, at 11:10 a.m., in room 1100, Longworth House Office Building, Hon. Nancy L. Johnson (Chairman of the Subcommittee) presiding.

[The advisories announcing the hearing follow:]

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
June 21, 1996
No. OV-15

CONTACT: (202) 225-1721

Johnson Announces Hearing on the Impact of Tax Law on Land Use

Congresswoman Nancy L. Johnson (R-CT), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee will hold a hearing on the impact of Federal tax law on land use. **The hearing will take place on Thursday, July 11, 1996, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 10:00 a.m.**

BACKGROUND:

The Internal Revenue Code includes a number of provisions that have an impact on land use. Among them are the tax credit for rehabilitation expenditures; incentives for locating businesses in empowerment zones (an employment and training credit, an additional $20,000 per year in section 179 expensing, and a new category of tax-exempt private activity bonds); the tax treatment of environmental remediation costs; preservation easements to minimize Federal estate taxes; an income tax deduction for donating an easement to a qualified organization for conservation purposes; and an estate tax preference for farms and small businesses.

In announcing the hearing, Chairman Johnson stated: "A number of provisions of current tax law have both intended and unintended consequences for land use. For instance, owners of historic property can establish preservation easements before they die to minimize Federal estate taxes and to protect the property in perpetuity. They can also take a deduction for contributing the easement to a qualified organization. The public policy objective is clear.

On the other hand, some have argued that current cost recovery provisions discourage businesses from investing in urban areas. A plant or equipment can be depreciated, but the land on which a factory is built cannot. That often means that a greater portion of an investment in non-urban areas can be depreciated. We need to look at whether this discourages businesses from investing in cities."

FOCUS OF THE HEARING:

A number of these provisions were enacted piecemeal over the years. The hearing will examine the net effect, if any, of the various provisions on land use decisions.

DETAILS FOR SUBMISSIONS OF REQUESTS TO BE HEARD:

Requests to be heard at the hearing must be made by telephone to Traci Altman or Bradley Schreiber at (202) 225-1721 no later than the close of business, Monday, July 1, 1996. The telephone request should be followed by a formal written request to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The staff of the Subcommittee on Oversight will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee staff at (202) 225-7601.

(MORE)

In view of the limited time available to hear witnesses, the Subcommittee may not be able to accommodate all requests to be heard. Those persons and organizations not scheduled for an oral appearance are encouraged to submit written statements for the record of the hearing. All persons requesting to be heard, whether they are scheduled for oral testimony or not, will be notified as soon as possible after the filing deadline.

Witnesses scheduled to present oral testimony are required to summarize briefly their written statements in no more than five minutes. **THE FIVE-MINUTE RULE WILL BE STRICTLY ENFORCED. The full written statement of each witness will be included in the printed record.**

In order to assure the most productive use of the limited amount of time available to question witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 200 copies of their prepared statements for review by Members prior to the hearing. **Testimony should arrive at the Subcommittee on Oversight office, room 1136 Longworth House Office Building, no later than 10:00 a.m. on Tuesday, July 9, 1996.** Failure to do so may result in the witness being denied the opportunity to testify in person.

<u>WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE</u>:

Any person or organization wishing to submit a written statement for the printed record of the hearing should submit at least six (6) copies of their statement, with their address and date of hearing noted, by the close of business, Thursday, July 25, 1996, to Phillip D. Moseley, Chief of Staff, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements wish to have their statements distributed to the press and interested public at the hearing, they may deliver 200 additional copies for this purpose to the Subcommittee on Oversight office, room 1136 Longworth House Office Building, at least one hour before the hearing begins.

<u>FORMATTING REQUIREMENTS</u>:

Each statement presented for printing to the Committee by a witness, any written statement or exhibit submitted for the printed record or any written comments in response to a request for written comments must conform to the guidelines listed below. Any statement or exhibit not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All statements and any accompanying exhibits for printing must be typed in single space on legal-size paper and may not exceed a total of 10 pages including attachments.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. A witness appearing at a public hearing, or submitting a statement for the record of a public hearing, or submitting written comments in response to a published request for comments by the Committee, must include on his statement or submission a list of all clients, persons, or organizations on whose behalf the witness appears.

4. A supplemental sheet must accompany each statement listing the name, full address, a telephone number where the witness or the designated representative may be reached and a topical outline or summary of the comments and recommendations in the full statement. This supplemental sheet will not be included in the printed record.

The above restrictions and limitations apply only to material being submitted for printing. Statements and exhibits or supplementary material submitted solely for distribution to the Members, the press and the public during the course of a public hearing may be submitted in other forms.

Note: All Committee advisories and news releases are now available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS_MEANS/' or over the Internet at 'GOPHER.HOUSE.GOV' under 'HOUSE COMMITTEE INFORMATION'.

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NOTICE -- CHANGE IN DATE/TIME/LOCATION

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
July 2, 1996
No. OV-15-Revised

CONTACT: (202) 225-7601

Change in Date/Time/Location for Subcommittee Hearing on the Impact of Tax Law on Land Use

Congresswoman Nancy L. Johnson (R-CT), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee hearing on the Impact of Tax Law on Land Use previously scheduled for Thursday, July 11, 1996, at 10:00 a.m., in 1100 Longworth House Office Building, **will be held instead on Tuesday, July 16, 1996 at 11:00 a.m., in room B-318 Rayburn House Office Building.**

All other details for the hearing remain the same. (See Subcommittee press release No. OV-15, dated June 21, 1996.)

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*****NOTICE -- CHANGE IN LOCATION****

ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

SUBCOMMITTEE ON OVERSIGHT

FOR IMMEDIATE RELEASE
July 15, 1996
No. OV-15-Revised

CONTACT: (202) 225-7601

Room Change for Subcommittee Hearing on Tuesday, July 16, 1996, on the Impact of Tax Law on Land Use

Congresswoman Nancy Johnson, (R-CT), Chairman of the Subcommittee on Oversight of the Committee on Ways and Means, today announced that the Subcommittee hearing on the Impact of Tax Law on Land Use previously scheduled for Tuesday, July 16, 1996, at 11:00 a.m., in B-318 Rayburn House Office Building, **will be held instead in room 1100 Longworth House Office Building.**

All other details for the hearing remain the same. (See Subcommittee press release No. OV-15, dated June 21, 1996, and No. OV-15-Revised, dated July 2, 1996.)

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Note: All Committee advisories and news releases are now available on the World Wide Web at 'HTTP://WWW.HOUSE.GOV/WAYS_MEANS/' or over the Internet at 'GOPHER.HOUSE.GOV' under 'HOUSE COMMITTEE INFORMATION'.

Chairman JOHNSON. The hearing will come to order. Good morning. It is a pleasure to have so many of my colleagues with us.

It is no secret that some of our Nation's most scenic open spaces are disappearing at a time when many cities; large and small, are decaying. There are many reasons for this, the development of the interstate highway system, relatively inexpensive commuting costs and tax incentives for home ownership, to name but a few.

Obviously, public safety, the quality of schools, the financial health of the Nation's cities figure prominently in decisions to move businesses and family to the suburbs. But a wide array of tax features have an impact as well, and as Congress considers a major overhaul of Federal tax laws, it is essential that we have a better understanding of the cumulative effect of these provisions.

For instance, it is difficult to recover many of the costs of development in urban areas. Many of the costs have to be capitalized into the basis of the land rather than into the depreciable basis of the building. On the other hand, the rehabilitation tax credit leveraged $483 million in private development activity in 1994 at a cost to the Treasury of $97 million. Saving historic buildings has helped revitalize a number of urban neighborhoods throughout the country. The rules surrounding the tax treatment of environmental remediation expenses are so convoluted and so confusing, it is no wonder that a number of businesses decide to sidestep them altogether and invest in newer buildings outside the environmentally distressed areas.

In rural areas, estate taxes can have a tremendous impact on land use decisions. According to one of our witnesses, the Piedmont Environmental Council, farmland that sold for $500 an acre in the sixties is selling for $10,000 and $15,000 an acre today. The tax cost of passing along such expensive acreage to the next generation, coupled with the pressure for development in many areas, is a major reason for the disappearance of open spaces.

There are features in current law to try to offset this. Family farms and businesses can be taxed on their current use value rather than full market value. Taxpayers can take a deduction for establishing conservation easements. Some have suggested that these provisions are inadequate. We will be hearing from several of our colleagues and other witnesses about alternatives.

Other provisions of the tax law that come into play include the deductibility of mortgage interest, an array of private activity tax-exempt bonds, and the treatment of investments and empowerment and enterprise zones.

Our colleagues, Charlie Rangel and Jim Talent and J.C. Watts have introduced enterprise zone legislation to build on and expand current empowerment zones in enterprise communities. Saving our cities and preserving our countryside, two of our Nation's most precious resources, are different sides of the same coin. We cannot accomplish one without the other.

Are all the answers to be found in the Tax Code? Of course not. But at the moment we may not even understand how many of the problems are exacerbated by the Tax Code.

There is an old parable about a flea riding on an elephant's back. They came to a stream and were crossing over on a bridge. When they finished crossing, the flea said to the elephant, "Boy, we sure shook that bridge, didn't we?"

Clearly, there are limits to what we can accomplish with the tax law, but we surely owe it to ourselves to make sure that we understand current law to satisfy ourselves that current law is not making matters worse, take corrective action if it is needed, and perhaps to find better ways to use tax law to both save our cities and open spaces.

Let me recognize my colleague, Mr. Matsui.

Mr. MATSUI. Well, I would just like to commend the Chair for holding these hearings.

I have a statement, and I will submit it for the record, but I do want to commend you and thank you for these hearings.

[The prepared statement follows:]

OPENING STATEMENT OF CONGRESSMAN MATSUI

HEARING ON THE IMPACT OF FEDERAL TAX LAWS ON LAND USE

SUBCOMMITTEE ON OVERSIGHT

JULY 16, 1996

At today's hearing, the Oversight Subcommittee will receive testimony from Members of Congress and the public about the impact of the Federal tax laws on land use.

I commend Chairwoman Johnson for scheduling this hearing, and look forward to hearing the witnesses' suggestions about proposals the Congress should consider to preserve this Nation's environment, to enhance our preservation of open space, and to revitalize our distressed communities.

The Subcommittee will receive testimony about: the tax credit for rehabilitation expenditures; incentives for locating businesses in empowerment zones and enterprise communities; initiatives for "brownfield" redevelopment and the tax treatment of environmental remediation costs; preservation easements to minimize estate taxes; and, estate tax preferences for farms and small businesses.

I should note that officials from the Department of the Treasury were unable to appear at today's hearing, due to the disruption resulting from the recent fire at main Treasury. However, the Administration has provided the Subcommittee with extensive information about their fiscal year 1997 budget proposals and will submit a written statement for the Subcommittee's hearing record.

In summary, the Administration proposes (as contained in H.R. 3747, introduced by Congressman Rangel) tax incentives for the clean-up of environmentally-contaminated urban and rural areas (known as "brownfields"), the designation of two additional urban empowerment zones within 180 days of enactment, authorization of 40 additional empowerment zones and 65 additional enterprise communities, and various enhanced tax benefits (including the availability of tax-exempt bond financing).

In a time of decreased Federal resources, we all must find new ways to address these important issues, and to revitalize our rural and urban areas in the process of decay.

I welcome the insight of the witnesses testifying before us today, and look forward to our discussion of the impact the Federal tax laws have on land use decisions.

Chairman JOHNSON. Thank you.

I am pleased to have with us so many of our colleagues who have given this issue a lot of thought, and thereafter a number of national organizations as well as local groups who are working hard and are very conscious of both the advantages and disadvantages of the current structure of our tax laws.

I am pleased also to have so many Members of the Ways and Means Committee.

Let me start with Hon. Clay Shaw.

STATEMENT OF HON. E. CLAY SHAW, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF FLORIDA

Mr. SHAW. Thank you, Madam Chairman.

As long as I have been on this Committee, it is the first time I have been at this table. You all are sitting a lot higher than I thought you were.

I would like to take this time this morning to briefly discuss a bill which I feel is very important to the purpose of this hearing.

I introduced H.R. 1662, the Historic Homeownership Assistance Act, along with our colleague, Barbara Kennelly, to provide prospective homeowners with a powerful incentive to help preserve and protect our Nation's historic homes and communities. It currently has 75 cosponsors. The bill, as others at this hearing will state, will accomplish several important goals in a cost-effective manner.

The first is enhanced home ownership. The credit would be available for those who purchase and renovate historic homes as their principal residences. Both single and multifamily homes may be rehabilitated. Twenty percent of the cost of the work could then be credited against the homeowner's Federal income tax liability, and that would have a cap of $50,000 per homeowner. If a developer repairs the home, the credit can pass through to the person who purchases the home from the developer. All of these provisions will make acquiring a qualified property much more attractive to the home buyers.

Second, I believe that this bill will be of great use to the communities which are struggling to restore their vitality. Over the past several decades, our cities have seen a virtual abandonment of large amounts of housing units. In order to bring people and businesses back into the city, we have to make housing a more attractive investment.

This Nation possesses massive urban infrastructure which is grossly underutilized. Instead of further extending suburban sprawl, we need to concentrate on restoring existing areas. While no panacea, H.R. 1662 would certainly be a step in the right direction.

Third, H.R. 1662 will help to achieve large-scale preservation of historic homes all over this country. I cannot emphasize enough how important it is to protect this vital American resource. Older homes are reminders of, and connections to, our Nation's history and our past. For all of the reasons I have spoken of, Madam Chairman, I believe that H.R. 1662 should be enacted.

Finally, as we have discovered over the past several decades, it is difficult to preserve not only historic homes and neighborhoods but also open lands and family farms. One of the main causes of the phenomenon of sprawl is the Tax Code, which often provides a disincentive to invest in existing infrastructure. In order to achieve our common goals of heritage and preservation, we must provide our homeowners, farmers, and families with a Tax Code that respects and fosters both our past and our future.

Having restored one of these old homes, I believe—I know, Madam Chairman, you have been in that home, and you live in one of the older homes here in the District—it is very expensive. These old homes are very temperamental, but I think it is very important that they be preserved instead of bulldozed, and I can tell you also, as a former mayor, that this would be tremendously important to the inner cities particularly and could help us out tremendously in the revitalization of our great cities.

Thank you.

Chairman JOHNSON. Thank you.

Mr. Houghton.

STATEMENT OF HON. AMO HOUGHTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. HOUGHTON. Thank you, Madam Chairman, for the opportunity to testify.

I ask that my written statement be included in the record.

I am here with my friend and colleague, L.F. Payne, to briefly discuss our bill, H.R. 864, which is the American Farm Protection Act. I might say that in addition to Mr. Payne, myself, and yourself, there are 11 other Members of the Ways and Means Committee who are cosponsors of this bill.

Now let me make four points very briefly.

First, why do we need such a bill? Because the family farms and ranchland around the urban areas and in our national parks is being developed at a very rapid rate. The development value of such property may greatly exceed the farming value of such property, forcing the sale on the death of the owner to pay estate taxes.

Second, how does the bill solve the problem? What it does is provide an exclusion from estate and gift taxes for the value of farm- or ranchlands subject to a qualified land conservation easement, and that is within 50 miles of a metropolitan statistical area or national park. That is pretty straightforward.

Third, does the Code already provide relief? Even though there are presently a number of measures in the Internal Revenue Code to provide some relief, they frankly are not effective. They just don't work.

Fourth, our bill provides for the conservation of America's important farm- and ranchland really through voluntary action without regulation, without cost of public acquisition and maintenance, and without taking land off the local tax roles.

Thank you, Madam Chairman. That is my statement.

[The prepared statement follows:]

STATEMENT OF THE HONORABLE AMO HOUGHTON (R., NY)
MEMBER , COMMITTEE ON WAYS AND MEANS
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
ON THE IMPACT OF TAX LAW ON LAND USE
JULY 16, 1996

Thank you, Madam Chairman, for the opportunity to testify before your subcommittee. This is an issue of importance, and one in which I have been involved during this Congress. I am delighted to join my colleague, L.F. Payne, who also has been deeply involved for many years.

As you and I and anyone living in rural and suburban areas of this country know, much of America's (historically and environmentally significant) land is under development pressure. This is often out of proportion to the expected demands of population growth, as sprawl leapfrogs development far beyond metro centers. Furthermore, this pressure is intensified by Federal tax laws, in particular estate tax law.

Specifically, the value of land in those parts of the country where ranches, farms and forests traditionally have flourished has skyrocketed -- this to the point where landowners' children can no longer afford the estate tax bill after their parents die. The result is predictable -- landholdings are split up and sold. The problem of course is that their land is often some of the best and most productive agricultural land in the nation. Today provisions in the law provide little or no relief from this burden, nor are current incentives in the law to preserve this land in its current, or a less developed state sufficiently attractive or workable to have much success.

That is why Mr. Payne and I, along with you, Madam Chairman, and 3 other members of your subcommittee, as well as 8 of our colleagues on the full Committee in a bipartisan effort have introduced H. R. 864, the American Farm Protection Act.

The American Farm Protection Act addresses the problem faced by the current generation of farm and ranch owners. It also provides an incentive to conserve valuable farm and ranchland in this country. The legislation does this by providing an exclusion from the estate and gift tax for the value of the portion of the decedent's estate that consists of land subject to a qualified conservation easement.

The American Farm Protection Act would enable America's farm and ranch families to continue to do what they do best: take care of America's rural lands. It would eliminate the Federal Government from a family's decision whether to maintain the farm, ranch, or forest. In other words, the American Farm Protection Act protects farm, ranch and forest land and the families who own it. It does so without regulation, without taking the land off the local and state tax rolls, and without imposing on the American taxpayer the costs of acquisition, administration, or maintenance of the land. The legislation provides an entirely voluntary approach for a rural landowner to use to preserve the land for rural purposes.

I believe our bill can be an important tool for America's farm and ranch families. It will permit them to preserve their homesteads, and at the same time make a significant contribution to the larger public good of conserving America's increasingly threatened rural lands.

As you know, Madam Chairman, a more limited version of our legislation was included in the vetoed Balanced Budget Act of 1995. We look forward to seeing our original bill included in the next viable tax vehicle that comes through this Committee.

Thank you for the opportunity to testify. I now defer to my colleague and an original sponsor of this important legislation, Congressman Payne.

Mr. HOUGHTON. I would like now to defer to my colleague, Congressman Payne.

Chairman JOHNSON. Yes. Mr. Payne.

STATEMENT OF HON. L.F. PAYNE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VIRGINIA

Mr. PAYNE. Thank you very much, Madam Chairman, Mr. Matsui, members of the panel. And thank you, Amo, for all the work that you have done on this legislation, the American Farm Protection Act, H.R. 864.

As it relates to the future, as it relates to future generations, I truly believe that this is perhaps one of the most important pieces of tax legislation that we can enact in this Congress. I want to thank all of my colleagues who are here and have cosponsored this bill, and I would urge others to join us in this effort.

Every day our country loses over 4 square miles of farmland to development. One of the criticisms that we hear of a bill such as this is that what we are doing is looking at ways that will add loopholes for wealthy people. In that regard let me take my few minutes, if I might, to tell you about one such person who would be affected by this—one such family that would be affected by this legislation.

Bob Lange is a full-time farmer in Malvern, which is a small town 24 miles west of Philadelphia in Chester County, Pennsylvania. Bob was here before us, the Ways and Means Committee, on this very issue and testified in the last Congress. He operates a family farm which is currently owned by his 93-year-old grandmother and has been in his family since 1896. His farm is 226 acres. It is an active farm, everything from corn to strawberries to pumpkins, but because of its proximity to Philadelphia, the fair market value of his farmland is 10 to 15 times higher than typical farmland in Pennsylvania. This is because the fair market value is determined by looking at what that land would be worth if it was developed for residential or commercial purposes and not for its current farm use.

This is a crucial point, because when the owner of this farm dies, the Federal estate tax law requires the fair market value of the farm as developed land be included in the decedent's estate. Most heirs like Bob cannot afford the estate tax bill when the farm is valued in this manner. Even when you take advantage of the limited provisions in the existing tax law, including the unified credit deduction for the donation of qualified conservation easements, farm families typically don't have enough liquid assets to pay an estate tax of as much as 55 percent of the estate's value.

So this is not a bill that is designed to provide some tax relief for the rich; this is for farm families across this country to ensure that they would be able to maintain their farms and be able to continue to use those as they have in the past and not be forced to sell off parts of these or split these up.

This is also, as Amo has already pointed out, the very best way that we could act to ensure that we maintain good, open spaces in and around our national parks and in and around our metropolitan areas.

We think this is good legislation. It is supported by not only a lot of Members on this Committee and in Congress, both Democrats and Republicans, but groups such as the American Farm Bureau, the National Farmers Union, the American Farm Land Trust, the Land Trust Alliance, the National Trust for Historic Preservation, the National Audubon Society, the National Forest Council, and many others. We would hope that in the remaining time that we have in this Congress that this legislation could be moved forward and could become law.

Thank you very much. I would like to put my statement into the record.

Chairman JOHNSON. So ordered.

[The prepared statement follows:]

Statement of Rep. L.F. Payne
Subcommittee On Oversight
Committee on Ways and Means
July 16, 1996

Thank you, Amo, for your remarks, and thank you, Madam Chairman, for this opportunity to testify before the Subcommittee on oversight on these important land issues. I have had the privilege of working with Amo this Congress on the American Farm Protection Act, which I had introduced last Congress as the Open Spaces Preservation Act. I truly believe this is one of the most important pieces of tax legislation that we could enact this year. I also want to thank all of my colleagues who have cosponsored this bill, and I would urge others to join us in this effort.

Every day this country loses over 4 square miles of farmland to development. The reasons are multiple, but the Federal estate tax plays a significant role in this phenomenon. To understand why, take the case of Bob Lange, a full-time farmer in Malvern, a small town 24 miles west of Philadelphia in Chester County, Pennsylvania.

Bob testified before the Ways and Means Committee on this issue during the last Congress. He operates his family's farm, which is currently owned by his 93-year-old grandmother, and has been in the family since 1896. The farm is 226 acres. It is an active working farm. Bob grows everything from corn to strawberries and pumpkins. Because of its proximity to Philadelphia, however, the fair market value of his farmland is 10 to 20 times higher than typical farmland in Pennsylvania. This is because fair market value means the value of the land when developed for residential or commercial purposes, not the value at its current farm use. This is a crucial point, because when the owner of the farm dies, the federal estate tax law requires that the fair market value of the farm as developed land be included in the decedent's estate.

Most heirs cannot afford the estate tax bill when the farm is valued in this manner. Even taking full advantage of the limited relief provisions in the tax law, including the unified credit and the deduction for the donation of qualified conservation easements, farm families typically do not have the liquid assets to pay an estate tax of as much as 55% of the estate's value.

The tax law's special valuation rules for farmland appear intended to reduce this burden. However, the complexity of the section makes it very difficult for most farm families to understand or use. Also, there is a cap on the amount by which the value of the estate can be reduced. Moreover, the fact that a Federal tax lien remains on the property during the recapture period makes this relief unworkable for farm families, whose need for operating loans to farm continues. Thus, the heirs are forced to sell some or large portions of the farm to meet their tax obligations. Sale of even a portion of the farm may make the remainder uneconomical as a farming unit.

That is why Amo and I, along with you, Madam Chairman, and, as Amo noted, 3 other members of this Subcommittee, as well as 8 of our colleagues on the full Committee, in a bi-partisan effort, have introduced H.R. 864, the American Farm Protection Act.

There are some who persist in criticizing any kind of meaningful estate tax relief as a special interest provision for the wealthy. Bob Lange is not a wealthy man. He holds an asset that is valuable only if it is put to a use other than the one it is currently serving -- a use, moreover, that would destroy everything Bob and his family have labored for three generations to preserve. I do not believe that Congress could have intended the estate tax laws to force the break-up and sale of this country's family farms, ranches, and environmentally significant forests and wetlands because there is a hypothetical chance that these landowners could be wealthy.

I believe we will have missed a priceless opportunity to leave something other than a huge federal debt to our children and grandchildren if we fail to get this bill enacted. By offering people an incentive to conserve America's increasingly threatened rural lands, while at the same time enabling them to keep their family homesteads intact, we will have given our children and grandchildren a better chance of enjoying a healthy environment and a comparable standard of living.

As you know, Madam Chairman, a more limited version of our legislation was included in the vetoed Balanced Budget Act of 1995. I urge my colleagues to support our efforts to include our original bill in the next viable tax vehicle that comes through this Committee.

Later today, you will hear from one of my constituents, the Piedmont Environmental Council, who will give you a more detailed and technical explanation of the effects of present law on family farms, ranches, forests and other rural and environmentally sensitive land. I appreciate the opportunity to testify with my good friend Amo Houghton today.

Chairman JOHNSON. Mr. English.

STATEMENT OF HON. PHILIP S. ENGLISH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. ENGLISH. Thank you, Madam Chair, Members of the Subcommittee. I want to thank you for the opportunity to testify here today at this hearing and to speak to the provisions of the American Community Renewal Act of 1996, H.R. 3467. By your leave, I would like to submit my testimony for the record and make some general comments.

This legislation, which was introduced by Representatives J.C. Watts, Jim Talent, and 46 others, including myself, will be examined much more closely and by a number of other Committees because it is broad-ranging legislation. However, today I specifically want to focus on a number of tax provisions in the bill and how the implementation of these provisions relates to current law and disincentives for businesses to invest in depressed communities.

The Community Renewal Act is designed to revitalize families, neighborhoods, and local business areas in America's impoverished communities. H.R. 3467 will provide greater economic opportunities and new hope for millions of disenfranchised Americans trapped in poverty. It will do so by encouraging private sector job creation in the community, providing opportunities for home ownership, and bolstering private charitable activity, along with a number of other incentives.

Title I of the legislation builds on the enterprise zone legislation concept that has been before Congress in the past. It includes the tax incentives in the Abraham-Lieberman bill currently in the Senate which contains legislation I introduced in the House, the Commercial Revitalization Tax Act, H.R. 2138, and the Riggs, English, and Weldon bills in the House on enterprise zones.

The purpose of title I is to liberate the economic forces within disadvantaged communities through the Tax Code by fostering an atmosphere where real private sector businesses and jobs are created and recognizes that new and expanding small businesses are best suited to provide jobs, particularly in urban neighborhoods. It comes invested with specific ideas that urban entrepreneurs believe are necessary to restore the economy in depressed communities.

Specifically, title I would create 100 renewal communities. To qualify, a community would have to have a poverty rate of 20 percent or more, an unemployment rate of at least 1.5 times the national rate, and at least 70 percent of the households having incomes below 80 percent of the median level of households, and have a population decline of 20 percent or more between 1980 and 1990.

Second, it would require that local communities reduce tax rates and fees within zones and eliminate State and local taxes to be eligible for community designation.

Third, it would create substantial Federal tax incentives for renewal communities, including an elimination of the capital gains tax on investments and stock business property or partnerships within zones so long as the assets are held for 5 years or longer. It would also include a business tax credit for hiring disadvantaged workers.

Fourth, it would give State and local governments the ability to request waivers to oppressive Federal regulations within the zones.

Fifth, it would create family development accounts to provide EITC recipients with a vehicle for enhanced personal savings.

Sixth, the bill would also include tax credits for commercial revitalization based on legislation that I introduced.

H.R. 2138, the Commercial Revitalization Tax Act, creates a tax credit that may be applied to construction, amounting to at least 25 percent of the basis of the property, which takes place in specially designated revitalization areas. Qualified taxpayers could choose a one-time 20-percent tax credit against the cost of new construction or rehabilitation.

Annually, the credit would be allocated to each of the States according to a formula that takes into account the number of localities where over half the people earn less than 60 percent of the area's median income. Localities would determine their priority projects and forward them to the State for allocation of credits according to an evaluation system which the States would establish. This would create a device for greenlining many of our downtowns in depressed communities.

Finally, title III of the American Community Renewal Act contains a provision that I will discuss and that I think is particularly important, a charitable tax credit. The legislation creates a nonrefundable 75-percent tax credit for up to $200 per taxpayer per year for donations to charities engaged in helping low-income Americans.

To be eligible, charitable organizations must engage in activities generally aimed at assisting individuals who earn 185 percent of the poverty line or below, obtain their State tax-exempt status, and spend no more than 20 percent of their aggregate expenses on administration, fundraising, lobbying, and litigation.

Madam Chair, I firmly believe that the current laws discourage businesses from investing in urban areas and getting people out of the poverty trap. What we are hoping with this legislation is to provide a vehicle for providing incentives to rebuild our cities and revitalize neighborhoods.

I thank you for the opportunity to testify, and we certainly hope that this legislation will see the light of day some time in the near future to help many of our communities that most need it.

[The prepared statement follows:]

Testimony
The Honorable Philip S. English
before the House Ways and Means
Subcommittee on Oversight
July 16, 1996

Madam Chairwoman and Members of the Subcommittee, I want to thank you for holding this important hearing and for allowing me to address my colleagues and everyone in attendance today on the "American Community Renewal Act of 1996," H.R. 3467. This legislation, introduced by Representative J.C. Watts and Representative Jim Talent and forty-six others including myself will be examined much more closely at future hearings. Today, however, I want to focus on several specific tax provisions in the bill and how the implementation of these provisions relates to current law and disincentives for businesses to invest in urban areas.

The "American Community Renewal Act," is designed to revitalize families, neighborhoods, and business sectors in America's impoverished communities. H.R. 3467 will provide greater economic opportunities and new hope for millions of disenfranchised Americans trapped in poverty. It will do so by encouraging private-sector job creation in the community, providing opportunities for home ownership and bolstering private charitable activity, among other incentives.

Title I of the legislation builds on the enterprise zone legislation Jack Kemp offered in the 100th Congress. It includes the tax incentives in the Abraham-Leiberman bill in the Senate which contains legislation I introduced in the House, the "Commercial Revitalization Tax Credit Act," H.R. 2138, and the Riggs/English and Weldon bills in the House on empowerment zones. The purpose of Title I is to liberate the economic forces within disadvantaged communities by fostering an atmosphere where real private sector businesses and jobs are created. It recognizes that new and expanding small businesses are best suited to provide good jobs in urban neighborhoods. It comes from specific ideas that urban entrepreneurs believe are necessary to economically restore our low-wealth communities. Specifically, Title I would:

- **Create 100 "Renewal Communities." To qualify, an area must have a poverty rate of 20 percent or more, an unemployment rate at least 1 1/2 times the national rate, and at least 70 percent of the households must have incomes below 80 percent of the median income of households, and have had a population decline of 20 percent or more between 1980 and 1990.**

- **Require local communities to reduce tax rates and fees within zones and eliminate state and local taxes to be eligible for community designation.**

- **Require state and local governments to waive local occupational licensing regulations and other barriers to entry, except those explicitly needed to protect health and safety.**

- **Create substantial federal tax incentives for renewal communities including an elimination of capital gains taxes on investments in stock business property, or partnerships within zones so long as the assets are held for 5 years or longer. As well, the bill would include a business tax credit for hiring disadvantaged workers. (provisions from Riggs/English)**

- **Gives state and local governments the ability to request waivers to oppressive federal regulations within the zones. These regulations will be selected from those outlined by the Commission on Unfunded Mandates. (Riggs/English)**

- **Finally, the bill also includes tax credits for commercial revitalization based on legislation I introduced, the "Commercial Revitalization Tax Credit Act (CRTC)," H.R. 2138.**

H.R. 2138 creates a tax credit that may be applied to construction, amounting to at least 25 percent of the basis of the property, which takes place in specially-designed revitalization areas, including enterprise communities, empowerment zones and other areas specially designated according to federal, state or local law. Qualified taxpayers could choose a one-time 20 percent tax credit against the cost of new construction or rehabilitation. Annually, the credit would be allocated to each of the states according to a formula that takes into account the number of localities where over half the people earn less than 60 percent of the area's median income. Localities would determine their priority projects and forward them to the state for allocation of credits according to an evaluation system which the states establish.

Title III of the "American Community Renewal Act" contains the final provision I will discuss today: a charitable tax credit. The legislation creates a non-refundable, 75 percent tax credit for up to $200 per taxpayer/per year ($400 for joint filers) for donations to charities engaged in helping low-income Americans. To be eligible, charitable organizations must: engage in activities generally aimed at assisting individuals who earn 185 percent of the poverty line or below; obtain their state tax-exempt status; and, spend no more than 20 percent of their aggregate expenses on administration, fund-raising, lobbying and litigation.

Madam Chairwoman, I firmly believe that current laws discourage businesses from investing in urban areas and, in fact, contribute to prolonging the poverty trap. Legislation like Reps. Talent and Watts have introduced is necessary to provide incentives to rebuild our cities.

Madam Chairwoman, this is not just a Republican solution. The ideas in this legislation have come from communities, and I believe they are good ideas that make sense. The "American Community Renewal Act" incorporates the ideas of the community leaders who already are making a difference. It is an aggressive urban policy that relies on the vitality of people while recognizing the limits and dangers of big government.

Thank you for the opportunity to testify.

Chairman JOHNSON. Thank you very much, Mr. English.
Mr. Zimmer.

STATEMENT OF HON. DICK ZIMMER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW JERSEY

Mr. ZIMMER. Thank you, Madam Chair. I appreciate your having this hearing.

I have been interested in open space preservation for a number of years. When I was a freshman in the New Jersey State Assembly, I sponsored New Jersey's farmland preservation law, which has saved some 40,000 acres of land from development. That may not seem a lot to people from districts like Mr. Herger's and Mr. Laughlin's, but in New Jersey, which is the most densely populated State in the country, that is a pretty large piece of undeveloped land.

The first bill that I sponsored in this Congress that became law was one that would expand the boundaries of a national park in New Jersey, and the history of that property is worth noting, because it is what brought to my attention one of the problems of the Tax Code as it relates to the preservation of open space.

The New Jersey property in question had been owned by Sterling North who was a well-known 20th century novelist. After Mr. and Mrs. North died, their children could not afford to pay the estate taxes on the land, even though the Norths and their children and the National Park Service all wanted to include this land as part of the Morristown National Historical Park. So they had to sell their land.

Fortunately, we were able, through a couple of bills that became law, to put this land into the National Park System. But it was a close call, and it might have been sold to a developer who would have taken it out of the potential ambit of the park forever.

This experience led me to introduce a bill specifically designed to encourage the donation of inherited property to the Federal Government. This legislation, which is pending before this Committee, is called the Open Space Acquisition and Preservation Act, and it allows heirs who donate real estate to the Federal Government to subtract the fair market value of this land from their estate taxes. It is narrowly drawn so that the land has to be undeveloped and it has to be sought for conservation purposes by a Federal agency such as the National Park Service.

I have introduced a second bill relating to open space that is pending before this Committee which was inspired by a practical problem encountered in the implementation of the New Jersey farmland preservation law that I referred to earlier.

This bill, the Land Preservation Tax Fairness Act, affects people who, in order to preserve open space, sell their land or a development easement in that land at below market value to a government entity or to a nonprofit organization.

In New Jersey specifically, our Farmland Preservation Program is so popular that there is not enough funding to pay full market value for the easements that are sold by farmland owners, so many of them are selling their easements at less than fair market value. When they do that, if they do it and realize a capital gain, which is the typical case, they end up paying a greater capital gains tax than they would have if the sales price was actually fair market value.

They are paying twice, in effect. They are accepting less than the fair market value of the development easement, and then they are paying a greater capital gains tax on the sale, because it is considered to be a "bargain sale" under tax law, which means that the full value of the property's basis cannot be subtracted from the sales price. I can go through a hypothetical example of how that penalty would affect the typical seller, but I will do it only if asked in the question and answer period.

Basically, this legislation would treat more fairly people who have already decided to accept less than the fair market value that they could have accepted for the sale of their land or an interest in it. I think that is unfair, and it discourages the preservation of open space.

Because donations and sales of undeveloped land are greatly influenced by tax treatment, these modest changes in the Tax Code could help to enhance open space preservation and assist in protecting America's heritage.

Madam Chair, you referred to the story of the flea on the elephant. The flea on the elephant sometimes can make the bridge shake a lot more than the elephant alone could. While I deeply hope that both my bills will become enacted into law, I must also underscore that they address only a small part of a larger problem, which is the bias of the Tax Code against preservation of open areas.

Current tax policies favor short-term investments in land development over long-term investments in open space preservation. Fairness should dictate tax policies that remove the current incentives to convert land to cash.

For instance, our Tax Code offers tax-exempt bond financing to businesses that build in empowerment zones but not those which purchase the land or the existing improvements in an empowerment zone. And, because the IRS levies estate taxes based on the value of a parcel's highest and best use, people often have to sell their land to a developer just to pay estate taxes.

According to American Forest magazine, most forest owners—and I am quoting now—most forest owners simply don't invest in maintaining their forests because tax policies make it almost impossible to deduct these costs on their tax returns. Instead, they extract some value by selling land fragments for development or cutting some timber.

Fortunately, the motivation for many people is beyond economic gain, and most people who donate land for the purpose of open space preservation don't do it for financial benefit. But there are many others who simply can't afford to make such a donation or set their land aside because of punitive tax policies, and as the population of landowners grows older, this problem will only get worse. Open space will continue to be threatened unless we are able to correct the current imbalance in the Tax Code. It is not too late to address this problem, and I am glad that you have begun this process now.

I thank you, Madam Chair.

[The prepared statement follows:]

TESTIMONY OF THE HONORABLE DICK ZIMMER
Ways and Means Oversight Subcommittee
Hearing on the impact of the Federal tax law on land use
July 16, 1996

Madam Chairwoman,

Thank you for your commitment to examining the impact of the U.S. tax code on the preservation of land.

This has been an issue of concern to me since I served in the New Jersey legislature. As an Assemblyman, I sponsored New Jersey's Farmland Preservation Act that has preserved more than 40,000 acres of open space from development. And the first bill of mine in Congress that became federal law involved open space and historic preservation -- a bill enabling the national park service to purchase a significant piece of property in new jersey adjacent to an existing 1,670 acre national park. The history of that property is worth noting, because it is what brought my attention initially to one way that the tax code can discourage our efforts to preserve open space.

The New Jersey property had been owned by Sterling North, the well-known 20th century novelist. After Sterling North and his wife, Gladys, died, his children were forced to sell the property to pay estate taxes. The National Park Service wanted the property as an addition to the Morristown National Historical Park, but North and his wife had not provided for such a donation in their wills, and their children could not afford to donate the land.

This experience led me to introduce a bill specifically designed to encourage the donation of inherited property to the federal government. The bill, which is pending before this committee, is called The Open Space Acquisition and Preservation Act, it allows heirs who donate real estate to the federal government to subtract the fair market value of the land from their estate taxes. The land has to be undeveloped and sought for conservation purposes by a federal agency, such as the National Park Service.

I have introduced a second land preservation bill which was inspired by a practical problem encountered in the implementation of my farm preservation law. That bill -- The Land Preservation and Tax Fairness Act -- affects people who, in order to preserve open space, sell their land or a development easement at below market value to a government entity or a nonprofit organization. Federal tax policy does not treat the gain from such sales fairly. The taxable gain from a "bargain sale" is calculated by subtracting only a fraction of the property's basis from the sales price, so the benefactor cannot receive the tax benefit that adequately reflects the original expense of purchasing the land.

For example, if land, purchased years ago for $200,000, and now worth one million dollars, is sold to a charitable organization for $500,000, the taxable gain would be calculated by subtracting just one half the original cost of the property -- $100,000 -- from the selling price of $500,000. In this case, the benefactor would not only forgo the additional $500,000 he would receive if he had sold it at its true value, but would also find his taxes increased by $28,000 (that is, 28% of $100,000), because of the impact of this rule. Clearly, the current system discourages charitable land preservation transactions.

My bill would amend the tax code so that the taxable gains from this kind of "bargain sale" would be calculated by subtracting the full basis from the selling price. Under my proposal, the individual in the hypothetical example could subtract $200,000 from the sale price of $500,000 lowering the net taxable gain to $300,000, instead of $400,000.

Because donations and sales of undeveloped land are greatly influenced by tax treatment, these modest changes in the tax code could help to enhance open space preservation and assist in protecting America's heritage.

While I deeply hope that both of my bills will become law, I also must underscore that they address only a small part of a larger problem, which is the bias of the tax code against preservation of open areas.

Current tax policies favor short-term investments in land development over long-term investment in open space preservation. Fairness should dictate tax policies that remove the current incentives to convert land to cash.

For instance, our tax code offers tax-exempt bond financing to businesses that **build** in empowerment zones -- not to purchase the land or the existing improvements -- but only to build.

And, because the IRS levies estate taxes based on the value of a parcel's "highest and best use," people often have to sell their land to a developer just to pay the estate taxes.

According to the *American Forest's* magazine, "most forest owners simply don't invest in maintaining their forest because tax policies make it almost impossible to deduct these costs on their tax returns. Instead they extract some value ... by selling land fragments for development or cutting some timber."

Luckily the motivation for some out there is beyond economic gain. Most people who donate land for the purpose of open space preservation don't do it for financial benefits. But there are many others who can't afford to because of punitive tax policies.

And as the population of land owners grows older this problem will only get worse.

Stephen Small, a Boston attorney and probably the leading authority on land preservation and the tax code, points out that an enormous amount of private land in this country is held by people who are 55 years and older, which means that over the next 15 to 20 years, millions of acres are going to change hands and potentially change use, depending on how landowners plan for their land's future.

Open space will continue to be threatened unless we are able to correct the current imbalance in the tax code.

I believe it is not too late to address this problem.

The process must begin now.

Thank you.

Chairman JOHNSON. I thank you all for your thoughtful testimony and for your legislative initiatives, and I believe that this Committee has given too little attention to how tax policy affects matters in both rural and urban areas.

A number of you have talked about changing the Tax Code to make it easier to preserve land for conservation or to develop easements across land. In looking at those issues, have any of you looked at the IRS' requirement that we value parcels at their highest and best use?

One of the possibilities would be to require the IRS to value land at its current use if its current use is going to continue, and only when its use changes, to then tax accordingly. Have any of you looked into that or have any reason to believe that that would be——

Mr. HOUGHTON. Well, Madam Chairman, I think that is really the basic thrust of the bill which Mr. Payne and I are suggesting. Rather than forcing our land to be at the highest and best value, which many times is in development of housing or things like that, that the tax, if sold, would be based on current use, which is not the case now.

Chairman JOHNSON. Thank you, Mr. Houghton. I wasn't clear on that from your testimony, whether that is the way your bill operates.

Mr. PAYNE. Let me just, I guess, reiterate what Amo has said, and that is that for estate tax purposes, when someone has placed their land in a conservation easement and when that easement is approved, then the purpose is that the value of the property would not be the highest investor use, that is, in the example I mentioned in Philadelphia, as a developed property, but, rather, that they would carry forward the basis of the property that they would currently have in lieu of that. That then would provide the kind of relief that they would need to be able to continue to provide this as open space or allow that conservation easement to actually work. But that is an integral part of making this bill a viable and workable bill.

Chairman JOHNSON. Are conservation easements broad enough? When you put something under a conservation easement, can you continue to farm it?

Mr. ZIMMER. In New Jersey, you can. That is the essence of the farmland preservation legislation. The easement is sold to a county agriculture development board.

In theory, it should be sold for the difference between the fair market value of the land and the land's value as restricted to agriculture, along with a residence that would be on the agricultural parcel. And then from then on, there is a restriction recorded with the deed which says that the land can be used only for farming, and that is the restriction of perpetuity. But the point is to restrict it for that purpose.

Other conservation easements can be crafted to reflect the purpose for which the conservation easement has been given; for instance, the protection of flood plain along a stream or other natural areas.

Chairman JOHNSON. But these are generally given, not purchased, like development rights?

Mr. ZIMMER. Well, as I said, in New Jersey they are purchased, but they can be donated as well.

Chairman JOHNSON. And under your bill, Mr. Houghton and Mr. Payne, they would be donated?

Mr. PAYNE. We would generally anticipate that they would be donated. It seems that there is a lot of interest of people now in doing this and donating, except for the fact that they run into this estate tax problem.

If we could find a way to, such as the requirements of our bill—if we could find a way to ensure that we can alleviate estate tax problems, I think there would be a considerable amount of land that might well be considered for conservation on a voluntary basis, which is why the elements of this bill are attractive. It does not require the governmental unit, whether it is the county or the State or the Federal Government, to actually purchase these, it achieves the same purpose, but it does it through the estate Tax Code.

Chairman JOHNSON. States are tending to run out of their development dollars that they have allocated in the past to the purchase of development rights.

Current law does require that family farms and real property used in closely held businesses can be included in estates at their current use value.

Have you found that the closely held business requirement is too narrow to help farmers who are trying to pass their land on to their kids for continued farm use?

Mr. PAYNE. There seem to be several concerns about that, and it does not seem to be providing the kind of incentive that we ought to provide. One, of course, is that it is capped at $750,000, and in the case of many larger farms that may not be sufficient.

Second, it is a program that requires that, beyond the event of death or when the estate transfers, that for some period of time that the same use continues—I think it is 10 years—and during that period of time, the Federal Government would have a lien on the property, which makes it very difficult then to borrow money to continue to operate in that regard.

There are requirements in terms of ownership prior to and after the estate changes hands, and I think all of those things add to some complexity that makes it generally not a very effective way of encouraging people to maintain their land and conservation easements.

Chairman JOHNSON. Thank you. That was very helpful.

Clay, on your proposal, to what extent does your bill reinstate the pre-1986 provisions of the historic preservation tax credit?

Mr. SHAW. I am not sure exactly what the details were in the 1986 provisions. I know that throughout the country, though, that the tax incentive that was in the law back then did a tremendous job for us across the country in historic preservation, but I am not sure exactly whether we tracked that law exactly or not with regard to the 20-percent tax credit.

I have been told that the pre-1986 law was for commercial property and this one is for homeowners. This is limited to homes. This does not get into the commercial side of things.

Chairman JOHNSON. Interesting. Thank you very much.

It seems to have enormous relevance to a city like Chicago where there are whole beautiful graystone shells.

Mr. SHAW. We also have an estimate from Joint Tax of $239 million over the 5 years.

Chairman JOHNSON. $239 million?

Mr. SHAW. It is less than what I thought it would have been.

Chairman JOHNSON. Thank you very much.

Mr. English, I thought you and your colleagues came up with some very good ideas, some of which could be applied without the enterprise zone concept behind them. Isn't that true?

Mr. ENGLISH. That is correct.

Chairman JOHNSON. I would have to say that in Connecticut, where we have developed the enterprise zone now quite radically in the last couple of years, there is developing a terrible tension among towns that got an enterprise zone and those that didn't and an imbalance in their ability to attract small industry, which they all need. So there are some problems with that.

I like the way you structured part of the tax credits in your bill. It really looked at the kind of indicators that directs those credits and places a preference.

I also liked the right of the State to direct the credits. This is what is now happening in the Low-Income Housing Tax Credit Program. Estates are setting the priorities as to where those projects ought to be directed, and it has been very fruitful.

Mr. Herger.

Mr. HERGER. I don't have any questions.

Mr. SHAW. Madam Chairman, can I insert something here, because I think it is tremendously important with regard to your comments to Mr. English.

Chairman JOHNSON. Yes.

Mr. SHAW. In the Human Resources Subcommittee, we are going to be taking a very close look at the inner cities' enterprise zones and different things that we are going to have to do in order to wean this country off of the present stagnant welfare system that we have. Perhaps you as Chairman of this Committee and I as Chairman of the Human Resources Subcommittee, perhaps at some future date we should look to have some joint hearings in order to explore more and more possibilities of how to work our way out of the current corrupt welfare system.

Chairman JOHNSON. I think that would be very useful, because one of the issues is going to be affordable housing in the cities, housing that is affordable fundamentally, not because of section 8 vouchers and things like that. So we really have a lot of work to do in that area, and I look forward to doing that with you.

Mr. Ramstad.

Mr. RAMSTAD. Thank you, Madam Chairwoman, and thank you for calling this important hearing today and for your leadership in this area. I truly believe this is an important hearing, and I applaud the leadership as well of our colleagues who are testifying in this first panel today.

I have long believed that the Tax Code should be used to meet land use objectives in general and to encourage environmental protection in particular. I am very interested in exploring, in these and other ways, how we can use tax incentives to encourage greater environmental protection, greater conservation.

I would like to focus on your bill, Mr. Houghton, which I think is an excellent piece of legislation. I am wondering if your bill limits tax benefits only to conservation of easements of farmland, or would other types of conservation easements be eligible as well?

Mr. HOUGHTON. No. It really is just real property, farmland and ranch property.

Mr. RAMSTAD. So it doesn't extend to other types of conservation easements.

Mr. HOUGHTON. No.

Mr. RAMSTAD. Also, why does your bill limit tax relief to land within a 50-mile radius of a metropolitan area? Why do you place that limitation?

Mr. PAYNE. Could I speak to that?

Mr. HOUGHTON. Sure, you bet.

Mr. RAMSTAD. You are a cosponsor, Mr. Payne, and I should recognize your efforts as well.

Mr. PAYNE. Thank you, Jim.

The intent here was to look to see what might be done reasonably, within reasonable cost limitations, to begin to find ways to protect important open spaces, and it really is a matter of economics. If, in fact, we had the whole country that was going to be taken in under this legislation, the cost of it would be much more than we thought would be affordable in this climate.

This bill, as it was last looked at by the Joint Tax Committee, with certain modifications, showed it had a cost of $781 million over 5 years. It was a more limited provision of this that actually was in the Balanced Budget Act that was passed by the House and the Senate that would have had a cost of $340 million over 7 years. This is not only in the areas of SMSAs or metropolitan areas within 50 miles, but also national parks as well, recognizing that they are already national treasures and we would be interested in looking at how they might be properly protected as well.

Mr. RAMSTAD. So the fiscal impact is what limited that application.

Mr. HOUGHTON. Yes.

If I could just add the difference in the cost between the provision and the balanced budget agreement, and this has to do with the radius, which is 50 miles in some areas and 25 in others.

Mr. RAMSTAD. I appreciate that clarification.

Mr. PAYNE. It is two things. First, it is fiscal, but second, it is looking at those areas that are most in need of some sort of easement or some sort of conservation. Otherwise, they will be developed in the very near future and we will never have an opportunity to conserve some of these areas for future generations.

Mr. RAMSTAD. Well, thank you again, gentlemen. And thank you, Madam Chairwoman.

Chairman JOHNSON. If the gentleman would yield on that, I wasn't quite clear on your response in terms of the difference between the Balanced Budget Act version of your bill and your bill. Is the primary difference that 25-mile radius as opposed to the 50-mile radius?

Mr. HOUGHTON. The primary dollar impact is.

Mr. PAYNE. I think it was a more limited version in that it was limited geographically. It is also limited in terms of the percentage of the estate that must fall into this category, which further limits and to some extent is somewhat problematic.

We think that ours is a better public policy and we would want to continue to work with the bill that we have, recognizing, though, that the concept has been approved by both the House and the Senate and that there are some things that could be done to modify it to make it a very good piece of legislation, we think.

Chairman JOHNSON. What is the limit on the percent of the estate that can be included?

Mr. PAYNE. The limit is 40 percent.

Chairman JOHNSON. So that functions like the $750,000 cap in current law.

Mr. PAYNE. It does. It becomes a limiting factor in terms of who would qualify for this particular provision. It is not necessarily on which pieces of land that most need to be protected or conserved but, rather, a percentage, an economic percentage of the estate is the criterion.

Chairman JOHNSON. Thank you.

Mr. Laughlin.

Mr. LAUGHLIN. Thank you, Madam Chairwoman, for calling this hearing. I thank all of my colleagues for the hard work they have done. It is important.

With all of you, the basic concern I have is, it sounds like you want to transfer title to all of this property to the Federal Government. I have a real problem with that, because in my State, we are a State where the Federal Government purchased or had donated all of the property, and I have an experience in my own district where substantial land has been taken off the local tax rolls.

It occurs to me also that the private landowner also has equal, and many times superior, capability to take care of this property than the Federal Government.

Is there a reason why we are transferring title, even when we are calling them conservation easements? Do any of the bills allow it to take place without transferring title from the landowner?

Mr. PAYNE. We are not talking about transferring the title, we are talking about providing an easement so that the title is maintained, private landowners continue to own their land. This provides them, though, the ability to do with their land what they would like to do, such as in the case that I had just mentioned where someone who wants to be able to continue to farm their land won't be able to do that when the estate passes, because the taxes will be so high, they will have to sell that.

This provides a way that we can allow that private property owner to do precisely with their property what they would like to do.

Mr. LAUGHLIN. Does yours and Amo's bill allow a family to continue farming without having a tax consequence just because the father or the grandfather or the grandmother has passed away?

Mr. PAYNE. That is precisely what this bill is attempting to do.

Mr. LAUGHLIN. Well, I like the thrust of your bill. But let me tell you a problem I have with your 50-mile radius and your national park provision.

As Mr. Zimmer accurately observed in his opening statement, not only Mr. Herger and I, but there are a number of other Members who have substantially large geographic districts, and they go way beyond this 50-mile radius from an MSA.

The concern I have is, just using the 14th District of Texas that I represent as an example, most of it is more than 50 miles from an MSA. But we have at least two interstates that go through my district, and within a short distance of every inch of that interstate the real estate values are unreasonably high because of developers and speculation, and you go 500 yards away, and the property drops in value substantially.

So I have a real problem with that 50-mile radius not taking into consideration some other factors, and then when you look at the national parks, there is not a national park that I am aware of within 50 miles of the 14th District, yet there are seven wildlife refuges within the district I represent, and those have as much value to the citizens and the Nation, and probably more value on the wildlife side, than the national parks do, yet we are not taking those into consideration, and in some of these the landowner has some restrictions.

So I would certainly ask you to consider adding wildlife refuges, because these are all under the control of the Federal Government. But I wonder how you would address this 50-mile phenomenon, and I know it is an arbitrary figure at this point, recognizing these interstates, and there is probably some other examples that artificially inflate the dollar value on ranch- and farmland.

Mr. PAYNE. Greg, I understand that in your district between San Antonio and Victoria——

Mr. LAUGHLIN. San Antonio and Houston, to give two large metropolitan areas, and that is 200 miles, so you come out——

Mr. PAYNE. It is not only the larger metropolitan areas. I understand that in your district, a substantial part of your district is covered by this, which I assume is one of the reasons that you are a cosponsor of this legislation. While I think it would be perhaps positive if we could find ways to expand its definition, one of the considerations is the cost, and the more we expand the definition, the more difficult it is to enact this legislation, as we have worked at it for several years.

But we would like very much to continue to work with you to find ways to accommodate the kinds of things that you have just mentioned.

Mr. LAUGHLIN. Well, that is the point I was making. I like the thrust of all of the bills, but sitting here listening to you, I have that concern that I mentioned.

Mr. Zimmer, I commend you for your legislation and certainly you are addressing issues that are important outside of the metropolitan areas, and particularly in districts that have a lot of farmland and ranchland.

The concern I have—and I would wish you to address it specifically in your bill—as I understand it, in every instance the landowner, to preserve that property for a well-intended use, must either sell or donate the property to the Federal Government. And if that is the case, why have you not considered the State government, in which in many instances our States have some very fine conservation programs within the State, or even local government?

And last, I would like for you to address the option of giving the easement and letting the landowner retain title, and in the instance of my State, they would be paying State and local taxes.

Mr. ZIMMER. There are two separate bills I have referred to. One deals not with easements but with title to the land, and that bill relates to the Federal Government. The other deals with easements but not transfers to the Federal Government.

The first one is basically designed to avoid all of the transactional costs involved in the transfer of inherited land to the National Park Service or the Fish and Wildlife Service or whichever Federal agency was intending to purchase the land in the first place. This has to be land that was already identified for acquisition and would have been bought with appropriated funds through either a negotiated sale or eminent domain by the Federal Government.

Under current law, the land goes to the heirs, the heirs pay the estate tax, and then whoever owns the land afterward sells it to the Federal Government in a process that costs more money than the simple credit arrangement that I would substitute for it. We would short circuit all of this and allow the heirs to transfer the land in lieu of the same value of dollars to the Federal Government in satisfaction of the estate tax burden.

So it doesn't expand the ownership of land by the Federal Government any more than what was intended in the first place; it simply makes it a short-circuit process rather than a convoluted, expensive one that may actually cost the taxpayers as well as the heirs more money.

The second bill contemplates the sale of an easement to a private conservation organization or typically a State or local government. It could involve, in theory, a sale to the Federal Government, but that was not what I had contemplated, because it was suggested to me as a result of the actual implementation of New Jersey's farmland preservation law, which involves the purchase of conservation easements by a county agricultural development board which is funded in part by the State, if those easements are purchased at fair market value, you pay the capital gains tax on the amount that you received, and there is no problem.

However, we have begun to run out of money, as the Chair pointed out was the case in Connecticut, for the purchase of as many easements as are for sale. So there are many landowners, out of a combination of necessity and philanthropic impulse, who are selling their easements at less than the fair market value.

When that is the case, it is categorized under a generic category in the tax law as a bargain sale, and you would end up paying a higher capital gains tax than would ordinarily be the case. That is unfair. It is a double hit on somebody who is taking less than fair market value, but it doesn't expand the ownership of land by the Federal Government.

Mr. LAUGHLIN. Under either of your bills, can a family pass on farmland?

Mr. ZIMMER. Both—well, the first bill is intended to transfer ownership of farmland, or whatever kind of land it is to the Federal Government. The second bill is designed to encourage a system which continues private ownership of land, and in New Jersey, at least, the taxes paid by that landowner are in no way diminished once the easement is sold, because our farmland is typically taxed at its agricultural value, not at its highest and best use for property tax purposes.

So there is no diminishment of property tax revenue to the local government, and, as I said, the land is owned—subject to the deed restriction—by the family. The family can will it to its heirs or it can sell it to another landowner who will buy it subject to the easement.

Mr. LAUGHLIN. Madam Chairman, I have taken enough time, but I think all of this truly points out why we need some tax reform passed by our Congress.

Chairman JOHNSON. I think your questions do point directly to that, and the quality of this panel's thinking on this subject not only bespeaks the urgency that Members feel about this but also the amount of work that has been done on it.

Mr. LAUGHLIN. Well, it also points out that the danger is maybe not to the generation of anybody on the panel or sitting up here looking down at Mr. Shaw, but it certainly will be to my grandchildren—and I have none at this stage, but my grandchildren's generation. How are they going to have ownership of any real estate to farm and ranch to help clothe and feed our citizens, 75, 100 years from now? I think this is a very important question for this Committee to consider, and I commend everybody on this panel for the important work you have done in that direction.

Chairman JOHNSON. Yes. I thank you, and I thank the panel very much.

I think one of the things we need to think about is that, as we constrain costs, we also create inequitable rights across the Nation, and we have to be very careful about that, and we may need to fight for a bigger package so that we have the same rights for people in a lot of different circumstances.

Mr. Payne.

Mr. PAYNE. Madam Chairman, before we leave, one of the people who will testify on the next panel is one of my constituents, Tim Lindstrom, who is testifying on behalf of the Piedmont Environmental Council. Tim is a very thoughtful person. The Piedmont Environmental Council is a very thoughtful conservation group, and I am pleased that they are able to be here to talk about our bill today.

Thank you.

Chairman JOHNSON. Thank you very much. I thank the panel for their excellent testimony.

The next panel will consist of Tim Lindstrom, Charlottesville office of the Piedmont Environmental Council, Charlottesville, Virginia; Jean Hocker, the president of the Land Trust Alliance from Washington, DC; and Irv Bell, the president of the Ohio Farm Bureau Federation, on behalf of the American Farm Bureau Federation.

Mr. ZIMMER [presiding]. Mr. Lindstrom, can you begin with your testimony, please.

STATEMENT OF C. TIMOTHY LINDSTROM, DIRECTOR AND STAFF ATTORNEY, CHARLOTTESVILLE OFFICE, PIEDMONT ENVIRONMENTAL COUNCIL, CHARLOTTESVILLE, VIRGINIA

Mr. LINDSTROM. Thank you, Mr. Zimmer and Members of the Subcommittee, for the opportunity to speak today.

My name is Tim Lindstrom, and I am an attorney with over 24 years of experience in estate tax, land use, and conservation law. I currently serve as an attorney with the Piedmont Environmental Council.

The Piedmont Environmental Council is a not-for-profit land conservation organization working in the northern Piedmont region of Virginia. We have extensive experience with conservation easements. We became involved in this legislation which Congressman Houghton and Congressman Payne described as the American Farm Protection Act back in the 101st Congress when Congressman Schulze first introduced it as the Open Space Land Act, and I would like to thank Mrs. Johnson for being one of the original cosponsors way back in the 101st Congress and sticking with it ever since.

Congressman Schulze became interested in this issue because he had constituents who were being forced out of farming by Federal estate tax on farmland ranging in value from $20,000 to $40,000 an acre. We became involved because of that concern, and because our experience with conservation easements convinced us that a more predictable and compelling incentive was needed for voluntary land conservation. It was to address these two goals, estate tax relief and providing a more compelling and clear incentive for land conservation, that this legislation was introduced.

While the Virginia Piedmont is characterized by dramatically inflating land values and urban sprawl, that certainly isn't a feature confined to the Virginia Piedmont. In fact, during the eighties, just to take one example, while the population of the State of Michigan grew by 33,000 people, which isn't very much, the amount of land consumed for urban and suburban uses in that same period of time increased by 40 percent.

A 1995 review of the USDA census of agriculture for the congressional districts which were then represented on the Ways and Means Committee showed that nearly 4 million acres of actively farmed land had been lost in just those districts alone since 1974. That is a loss of over 20,000 farms.

During the same period, the average value per acre of farmland in these districts increased by nearly 200 percent, so that nearly 26,000 farms just in these districts were exposed to potential Federal estate tax. In Mrs. Johnson's district alone, values since 1974 have increased by 280 percent, so that the average farm in her district is now worth $670,000.

As a 12-year veteran of the Albemarle County Board of Supervisors in Virginia, I know of the political and legal difficulties involved in trying to regulate the effective protection of farmland and open space. I also know that the cost of protecting land by outright purchase is prohibitive. That is why we support the American Farm Protection Act. We believe it is a very practical approach to protecting rural land under development pressure. It is voluntary;

it does not involve government regulation; it does not involve the cost of acquisition or maintenance of land.

While I recognize that the special use evaluation section of the Federal Tax Code, section 2032A, is designed to relieve farmers of the burden of estate taxes, in our experience, it has not been effective. Section 2032A is complex and difficult to qualify for. In addition, as Mr. Payne mentioned, there is a limit on the amount of tax savings allowed which has not been adjusted for a number of years, and a Federal tax lien is imposed on the farm for the duration of the agreement that is required under 2032A, and that tax lien significantly interferes with the farmer's ability to obtain operation and expansion loans. There is also no incentive in section 2032A for long-term voluntary protection of land.

The proposals which were introduced in this Congress to improve section 2032A as well as section 6166, which provides for installment payments of estate tax on certain farmland, will help a little bit. However, none of the proposed changes significantly improve the provisions of these sections which most discourage their use, and none of them provide an incentive for permanent, voluntary land conservation.

Current law allows a deduction for the value of conservation easements which have been donated. However, because the valuation process is very unpredictable, the extent of potential estate tax liability on land restricted by an easement is also uncertain, and that is a disincentive for people who are interested in conserving their land with that tool.

Current tax treatment of easement donations also tends to favor those who have large incomes and can take advantage of the income tax deduction under section 170(h). On the other hand, those who have little income but very valuable land, which is the case with many farmers, can find little tax advantage to donating an easement under the current law.

The American Farm Protection Act avoids all of these problems and provides simple, predictable, and effective estate tax relief as well as a compelling new incentive for voluntary land conservation. We thank you for your past support of this legislation and urge you to include it in any legislation moving through the Committee.

Thank you very much.

[The prepared statement follows:]

STATEMENT BEFORE THE SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
ON BEHALF OF
THE PIEDMONT ENVIRONMENTAL COUNCIL
BY C. TIMOTHY LINDSTROM
JULY 16, 1996

Thank you, Madam Chairman, and members of the Subcommittee for giving me this opportunity to speak to you today regarding the impact of federal tax law on land use in the United States. My name is Tim Lindstrom, and I am an attorney with over 24 years of experience in estate tax, land use, and conservation law. I currently serve as staff attorney to the Piedmont Environmental Council.

The Piedmont Environmental Council (PEC) is a not-for-profit land conservation organization working in the Northern Piedmont region of Virginia. We have worked with land owners for over 20 years advising them on estate tax matters and encouraging them to take steps to conserve their land - primarily through conservation easements. We have extensive experience with conservation easements. I should add that the PEC itself does not hold any easements because Virginia has a very excellent state agency, the Virginia Outdoors Foundation, which holds most of the conservation easements in Virginia.

The PEC became involved in H.R. 864, the legislation now known as the American Farm Protection Act, when Congressman Richard Schulze first introduced it in the 101st Congress as the Open Space Land Act. I would like to thank the Chairman, Mrs. Johnson, for being a co-sponsor of this legislation ever since it was first proposed by Congressman Schulze.

Congressman Schulze became interested in this issue because he had constituents who were being forced out of farming by federal estate tax on farmland ranging in value from $20,000 to $40,000 an acre. We became involved because of that concern, and because our experience with conservation easements convinced us that a more predictable and compelling incentive was needed if voluntary land conservation were to become a significant source of land conservation in the United States. It was to address these two goals: estate tax relief for the owners of rural land and the provision of a stronger incentive for voluntary land conservation, that this legislation was introduced.

The Piedmont region of Virginia, like many urbanizing areas, is characterized by dramatically inflating real estate values. Farmland which once sold for $500 an acre in the 1960s now sells for $10,000 to $15,000 an acre. It is also characterized in many counties by intense pressure for development which sprawls across open country at low densities, wasting land and further increasing the pressure for farm conversion.

Loss of farmland and sprawl is, of course, not limited to Virginia. During the 1980s, for example, while the population of the state of Michigan grew by only 33,000 people, developed land area increased by over 40%. A 1995 review of the USDA Census of Agriculture for the 32 Congressional Districts then represented on the Ways and Means Committee showed that nearly 4 million acres of actively farmed land had been lost in those districts alone since 1974. This represents over 20,000 farms. During the same period the average value per acre of farmland increased by nearly 200% so that nearly 26,000 farms were exposed to the federal estate tax in those districts. In Mrs. Johnson's district alone values have increased by 280% since 1974 and nearly 46,000 acres have been lost to farming. In 1992 the average farm value in Mrs. Johnson's district was $670,000.

As a 12 year veteran of the Albemarle County Board of Supervisors in Virginia, I am personally aware of the legal and political difficulties involved in trying to regulate the effective protection of farm land and open space. I also know that, while the purchase of development rights has an important role to play in protecting farm land and open space, the cost of these programs prohibits their being applied on the broad scale needed to protect a meaningful base of open land.

That is why we support the American Farm Protection Act. We believe that it is a very practical approach to protecting farm land and other land of conservation value that is under development pressure. It is voluntary and does not involve government regulation. It also avoids the huge costs of acquisition which include taking land off local tax rolls and requirements for maintenance.

Current estate tax law contains three provisions which are relevant to the protection of rural land. Section 2032A, which provides for special use valuation of certain farmland, ranch land and forest land; Section 6166, which allows certain estates containing farm or ranch assets to pay estates taxes in installments; and Section 2055, which allows a deduction for a testamentary bequest of a "qualified conservation contribution" as defined in Section 170(h) of the Internal Revenue Code of 1986. (A "qualified conservation contribution" is a conservation easement.) In addition, land subject to a "qualified conservation contribution" donated during a decedent's lifetime will be valued for estate tax purposes by taking into consideration the extent to which the conservation easement reduces the value of the land in the decedent's estate.

The problem is that these provisions of the current law are not effective. They are far too complex to be practical and too limited to provide effective relief. The provisions directed at conservation easements are too unpredictable in their effect and also too limited to provide a real incentive for voluntary land conservation.

A 1981 Government Accounting Office (GAO) study of Section 2032A concluded that "...special use valuation is difficult to administer and comply with, its complexity has tended to restrict its use to wealthy estates..." More recently, in her statement to the Senate Finance Committee on June 7 of last year, Deputy Assistant Treasury Secretary Cynthia Beerbower reported that she had informally surveyed practitioners and others familiar with the difficulties facing farmers and other family businesses and found that both Sections 2032A and 6166 were complex and difficult to utilize.

Surveys of federal estate tax returns filed between 1989 and 1991 indicate that an average of less than 3,500 estates elected treatment under Section 2032A; that is only 7% of all returns filed annually.

There are a number of reasons why Section 2032A is so little used. It is complex and difficult to qualify for; there is a limit on the amount of tax savings allowed, which has not been adjusted for a number of years; in order to qualify, all owners of land selected for Section 2032A treatment must consent to personal liability for deferred taxes; a federal tax lien is imposed which significantly interferes with the ability to obtain operating and expansion loans; and a number of other requirements also pertain. In addition, Section 2032A is not applicable to a considerable amount of land that is important because of its environmental sensitivity or proximity to national parks or wilderness areas. There is also no incentive in Section 2032A for the long-term voluntary protection of the land. In fact, the donation of a conservation easement on land subject to a Section 2032A election has been found by the Tax Court to violate requirements of this Section and trigger a recapture of tax savings.

Section 6166 applies only in certain circumstances, which will often preclude relief for estates holding land with publicly important conservation values. Even where it applies it leaves farm families with a continuing annual obligation which must be secured by a federal tax lien on the farm and which must compete with the many other economic demands on what may be a very limited income. Furthermore, like Section 2032A, Section 6166 provides no incentive for long-term voluntary land conservation.

Current law also allows a deduction (or, in the case of inter-vivos easement gifts, a reduction in estate value) for the value of conservation easements. However, the extent of the deduction and therefore the extent of remaining tax liability on the restricted land is unpredictable. This tends to discourage prospective donors who fear the easement may limit their heirs ability to sell land to pay the tax.

Current tax treatment of conservation easements also tends to favor those who have large incomes and can take advantage of the income tax deduction. On the other hand, those with very valuable land but small incomes find little advantage from donating an easement. Many farmers and ranchers fall into this category. For them the current tax benefits of easement donation provide little or no incentive. In addition, valuation of the easement is constantly challenged by the IRS in some parts of the country - a factor which has discouraged more than a few potential donors.

The American Farm Protection Act offers simple, predictable and effective relief and a compelling incentive for voluntary conservation to owners of land with publicly significant conservation value that is under development pressure. It does so by providing a full exemption from estate tax for land subject to a conservation easement meeting the existing standards of Section 170(h) of the Internal Revenue Code of 1986. We thank you for your past support of this legislation and urge you to include it in any legislation which may come before the Committee.

Chairman JOHNSON. Thank you very much, Mr. Lindstrom.
Ms. Hocker.

STATEMENT OF JEAN HOCKER, PRESIDENT, LAND TRUST ALLIANCE, WASHINGTON, DC

Ms. HOCKER. Madam Chair and Members of the Committee, I thank you a great deal for devoting your time and attention to this really important issue. I also want to thank Congressmen Zimmer and Houghton and Payne for your leadership in advocating new legislation to encourage private voluntary land conservation.

I am president of the Land Trust Alliance. It is a national nonprofit umbrella organization that provides services and assistance to the Nation's more than 1,100 land conservation organizations known as land trusts. Madam Chair, in your State alone, there are over 100 of these land trust organizations. In New Jersey, the New Jersey Conservation Foundation and many smaller groups have protected a great deal of land. I am happy to say that there are new land trusts forming now in Texas, and so we are seeing this movement of private voluntary land conservation groups spreading all across the country.

These groups usually serve a single community, a watershed, a valley, or other defined region, and their purpose is to work with landowners to protect, through voluntary means, natural areas, productive forest- and farmland, habitat, urban gardens, trails, greenways, and all kinds of open land.

Land trusts use many tools. They acquire and manage land for conservation, and very often they use the conservation easement, which is a tool we have talked about and heard a lot about this morning. It is sometimes a little difficult to understand how easements work, but basically they are legal deed restrictions on the future use of land. The restrictions protect the conservation values of the land while leaving the land in private ownership on tax rolls and in productive use. It is an extremely useful tool for voluntary land conservation.

What I want to do today is to describe not just one incentive but several incentives for encouraging private voluntary land conservation. First I want to say just a couple of words about why it is important for the Congress of the United States to enact new incentives.

Sound land use requires a mix of land that is built on and land that is not built on. Undeveloped land near where people live used to be easy to find because no one had gotten to that land yet. We all remember the vacant lots where we all played as a kid or the hillsides defined at the edge of town or down the block where you could watch tadpoles become frogs. People don't find that any more.

We need to take deliberate steps to ensure that there is some open space left. We need to plan for open space, because open land once built on will never again, in at least one human's timeframe, become available as open space. It is disappearing, and we are not going to get it back.

Land trusts are showing over and over in every State that many property owners do want to protect their land in a relatively undeveloped state, and they will do that voluntarily if they know how and if they have any incentives to do so.

As my written testimony points out, there are already incentives in the Tax Code for donations of land and gifts of conservation easements. No landowner that I know has protected land solely because of tax benefits. If there is a market for development, it is always, always more lucrative to develop the land. But the incentive is to help tip the balance for those landowners who have a conservation ethic, and provide tax incentives to encourage land protection at a public cost far lower than public land acquisition and management.

My written testimony addresses six new incentives for private voluntary land conservation. Some are significant changes. At least one is a minor adjustment to correct an existing impediment to easement gifts.

First, I would urge Congress to enact the American Farm Protection Act that is sponsored by Congressman Houghton and which Tim Lindstrom and others have talked about and will talk about more.

I would urge you to enact legislation advocated by Congressman Zimmer to permit an executor to donate land or a conservation easement as a credit against estate taxes, a very important issue to enable the heirs to make decisions that the decedent perhaps didn't make or was unable to make.

Enact also Congressman Zimmer's proposal to change the way land is calculated in order to encourage more below-market-rate sales.

Make tax incentives apply to people of modest income by increasing the percentage of income that can be deducted in any tax year for gifts of appreciated land or easements for conservation.

Change the current Tax Code provision that inhibits donations of conservation easements on land with severed mineral rights. This is a very little-known provision that is holding up a lot of easement donations, donations of people who would like to protect their land with conservation easements and cannot do it because of the provision on severed mineral rights.

And explore incentives to encourage good conservation management practices on private lands.

All of these proposals are consistent with a chapter I wrote in a book called "Land Use In America," which I would like to make available to the Committee. We also offer you our assistance in learning more about how conservation easements work, because we have done a good deal of work on that as well and have literature on it. We are pleased to make our assistance available.

Thank you, Madam Chair.

[The prepared statement follows:]

STATEMENT OF
Jean Hocker
PRESIDENT
LAND TRUST ALLIANCE

SUBMITTED TO THE

SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES

Hearing on the Impact of Tax Law on Land Use
July 16, 1996

Madam Chairman and members of the Subcommittee, I am pleased to submit testimony on the impact of tax law on land use, and to recommend changes to the tax code that would encourage private, voluntary conservation of land. I thank Chairman Johnson for calling this hearing, and also Congressmen Zimmer and Houghton for their leadership in advocating new legislation to encourage land conservation. I also commend the Subcommittee for making this effort to increase public and Congressional awareness of this important issue.

I am President of the Land Trust Alliance (LTA), a national membership organization serving the nation's more than 1,100 local and regional land conservation groups known as land trusts. Land trusts are nonprofit, tax-exempt land conservation organizations that are organized to protect natural areas, agricultural land, habitat, wetlands, greenways, urban gardens, recreational properties, and other kinds of conservation land for public benefit. Local and regional land trust organizations operate in every state, and have helped to protect nearly 5 million acres of irreplaceable open land. Together, these land trusts are supported by close to a million individual members.

Land trust organizations work to conserve selected lands of significant public value; many also act as community planning advisors, and nearly half conduct environmental education. No matter what their individual goals and methods, all land trusts share a philosophy of private, voluntary, common-sense, solution-oriented land conservation. Land trusts succeed through nongovernmental, nonregulatory, local citizen initiative. As a recent article in Small Town magazine stated, "Today's land trusts occupy a niche that links broad public interests in landscape protection with the desires and interests of individual landowners."

In communities across the country, land trusts promote good land use, which requires thoughtful planning for both development and open space. I am pleased to provide the committee with copies of a recent book on this topic, Land Use in America (Henry L. Diamond and Patrick F. Noonan, Island Press, 1996), to which I was asked to contribute an article. My testimony today is consistent with the tax recommendations in that article, beginning on page 257.

Land conservation tools. Land trusts rely on private action to save land. Their methods include acquisition of land and conservation easements by gift, purchase, or bargain (below market value) purchase; limited development that combines protected open space with appropriate development; acquisition of land for subsequent conveyance to public conservation agencies; land exchanges; and other direct methods. But these actions, though primarily private, are influenced significantly by public laws, policies, programs and rules. In particular, the land transactions that are at the heart of land trusts' work are affected substantially by incentives and disincentives in the tax code. While landowners virtually never conserve land solely for tax benefit, their decisions are usually determined in part by a cost-benefit analysis of the tax consequences of various options for managing their assets.

Conservation Easements. One of the principal ways land trusts protect land is by working with landowners to design conservation easements. The landowner, by means of a recorded legal instrument, restricts -- usually in perpetuity -- rights to use the land in delineated ways that would harm its conservation values. The extinguished rights are tailored for each property, depending on its conservation values and the owner's wishes. The recipient of the easement, either a nonprofit land trust or government agency, agrees to monitor and enforce the terms of the easement. Thus, the land remains in private hands, in productive use, and on tax rolls, but henceforth may not be used in agreed-upon, environmentally harmful ways. If the easement is perpetual, all future owners are also bound by the agreement. The monetary value of an easement, determined through a "before and after" appraisal, is generally equal to the amount by which the restrictions reduce the value of the property.

For the value of a conservation easement donation to qualify for a charitable deduction under I.R.C. Section 170(h), the agreement must meet rigorous public benefit tests. A qualified conservation easement must be perpetual and donated to a nonprofit that can enforce it appropriately, or to a government agency. It must meet one or more of the conservation purposes under law: for public recreation or education; for the protection of habitat; for the preservation of open space that has scenic qualities benefitting the public, or for the protection of open space which is consistent with governmental conservation policies. Historically important land, or certified historic structures, also qualify under 170(h).

Current tax code incentives. Several incentives for land conservation already exist in the tax code. However, their applicability is often limited.

Income tax deductions. The value of a donation of land or a qualified conservation easement is generally deductible from taxable income. However, the deduction for gifts of appreciated property is limited to 30 per cent of the taxpayer's contribution base in the year of the gift, with any additional value deductible in the five succeeding tax years. Thus property owners whose land or extinguished development rights are worth a great deal, but whose income is modest, are unable to deduct much of the gift value. In addition, an easement donated to protect land on which the mineral and surface estates were first separated after 1977 is unlikely to qualify as a deductible charitable gift under current tax law.

Reduction of estate taxes. Gifts of land and easements for conservation can also lower estate taxes by reducing the value of the taxable estate. This alone can be a major incentive for conservation donations, because land in an estate is typically valued and taxed at its development potential. All too often heirs without other sizable assets with which to pay the estate tax bill must sell for development land that was previously undeveloped or in low-impact use. So while current law does encourage sophisticated taxpayers with good estate planning advice to donate land or easements for conservation, land in the estate of a decedent who did not, or could not, take such steps will often have to be sold. Current law does not permit the heirs to make conservation donations to reduce estate taxes. In addition, in areas of rapidly escalating land values, the long term estate tax benefit of a conservation easement donation may not be substantial enough to serve as a strong incentive for conservation.

Bargain sales. It is often in the best interests of both a landowner and a cash-strapped conservation agency or nonprofit to transfer land through a bargain sale. The seller can claim as a charitable gift the difference between the land's fair market value and the amount he receives for the land. However, for determining the taxable gain on the transaction, current law generally requires that the taxpayer's basis in the property be allocated between the sale and gift portion. The taxpayer is denied any tax benefit for the basis assigned to the gift portion, thus diminishing the tax benefit and the incentive for a substantial bargain sale.

Recommended changes. The Land Trust Alliance supports six changes to the tax code that would strengthen incentives for land conservation.

1. We endorse the estate tax incentive in H.R. 864, the American Farm Protection Act, sponsored by Congressman Houghton. This legislation would exempt from estate tax the value of certain land subject to a qualified conservation easement. The legislation targets the benefit to land adjacent to metropolitan areas and national parks, where development pressure and land values tend to be greatest, and where the need to protect open space is particularly keen.

2. We endorse H.R. 522, the Federal Open Space Acquisition and Preservation Act, sponsored by Congressman Zimmer. This bill would permit an executor to donate land or a conservation easement to a government agency and credit the value of the donation against estate taxes owed. This provision would go far to diminish forced sales of conservation land by heirs in order to pay estate taxes. We recommend that this proposed benefit be extended to gifts of land and conservation easements made to any "qualified organization," as described in Section 170(h)(3) of the I.R.C., which includes both public agencies and nonprofit conservation organizations.

3. We endorse H.R. 523, the Land Preservation Tax Fairness Act, also sponsored by Congressman Zimmer. This bill would change the way that the gain on bargain sales of land or conservation easements is calculated for tax purposes. It would allow the entire basis in the property to be deducted from the gain realized, instead of requiring allocation of basis between the sale and gift portions of the transaction.

4. We recommend that the limitations on deductibility of gifts of land or conservation easements be liberalized. Because these gifts tend to be large, one-time gifts, and serve a high priority public purpose, incentives for such gifts should be strengthened and should apply to people of modest incomes as well as to the wealthy. We recommend that the deduction for conservation gifts of appreciated land or easements be increased to 50% of the taxpayer's contribution base, and that the portion of the donation not deductible in the year of the gift be deductible in subsequent tax years without limitation, until it is used up.

5. We endorse Title 5 of S. 910, which lifts an unnecessary exclusion from qualified conservation easements of land on which the surface and mineral estates are separated. Current tax law unnecessarily restricts the deduction for conservation easement donations that protect land on which the mineral estate was first separated from the surface estate after June 13, 1976. If the estates were separated before that date, the owner can make a deductible easement gift, as long as he can demonstrate that the probability of surface mining on the land is "so remote as to be negligible" However, when the surface and mineral estates were first separated after June 13, 1976, an easement donation generally does not qualify as a deductible charitable donation, even if the remoteness test can be met. This provision is already discouraging the protection of some environmentally significant properties and its negative impact will only increase as time passes. It is our view that the burden of proof placed imposed by the "so remote as to be negligible" test is adequate and appropriate to all property on which the mineral and surface estates are separated. There has been no abuse in 20 years under this law, and no instance in which land meeting the remoteness test was subsequently subject to surface mining. Title 5 of S. 910 (the Senate version of H.R. 864) would correct this problem by permitting deductible conservation easements on properties with severed mineral estates without regard to the date of separation, as long as the remoteness test can be met.

6. We endorse incentives that would encourage good conservation management practices. The incentives described above would go far to encourage voluntary conservation through gifts of land and easements to conservation organizations and agencies. However, we know that acquisition of land and easements -- by purchase or gift, by land trusts or government -- cannot adequately protect entire watersheds, habitats and other key open lands. Land conservation will continue to depend upon the management practices of private property owners. Thus we endorse the concept of rewarding, through additional income and estate tax incentives, those property owners whose management practices significantly advance public conservation policy goals -- for example, landowners who enter into binding agreements to manage for protection of endangered species habitat. To ensure that the public investment in such incentives is sound, their scale should be consistent with the public benefit received, the greatest incentives being offered for the longest term agreements.

Tax reform proposals. Finally, I would like to note the impact that the various proposals for a "flat tax" would have on land conservation. Like other members of the nonprofit sector, land trusts have serious concerns about any proposal that would end the charitable deduction. Unlike most other charities, however, land trusts rely on gifts not only for operating income, but also to carry out the basic function for which they are established and upon which their tax-exempt status is generally based. Without gifts of conservation land and easements, land trusts would have limited ability to carry out their missions. Flat tax proposals that allow deductions for a limited amount of annual giving do not address the matter of significant land and easement gifts, most of which are large, one-time donations whose value is far above the charitable deduction limits discussed in any of the flat tax proposals. We urge the committee, when evaluating such proposals in this and future Congresses, to give special consideration to their impact on the ability of private landowners to conserve their property through voluntary gifts of land and conservation easements.

The Land Trust Alliance is pleased to offer our assistance and expertise on the effect of the tax code on land conservation, and we encourage the Subcommittee to call on us. Thank you for devoting your time and attention to this important matter.

Chairman JOHNSON. Thank you very much.
Mr. Bell.

STATEMENT OF A.I. (IRV) BELL, PRESIDENT, OHIO FARM BUREAU FEDERATION, INC., ON BEHALF OF AMERICAN FARM BUREAU FEDERATION

Mr. BELL. Thank you, Madam Chairman.

My name is Irv Bell. I, along with my wife, Jean, and son, Matt, operate a feed grain, hog, and beef cattle farm in Muskingum County, Ohio. Our farm has been in the family for six generations. I serve as the elected president of the Ohio Farm Bureau Federation, and I am pleased to represent the American Farm Bureau Federation at today's hearing.

The Farm Bureau's interest in tax policy and its impact on land use is keen. The production of food and fiber requires the use of large amounts of land. Roughly 43 percent of the total land in this country is farm- and ranchland. If you do not count land owned by State and Federal Governments, farm- and ranchlands account for almost 70 percent of the privately-owned property.

First on the list of concerns that farmers and ranchers have about taxes that impact land use is the Federal estate gift tax. Like our farm, many farms and ranches are multigeneration family businesses. Estate taxes can make it very difficult for a family to continue to farm after the death of a loved one. When this happens, farmland that would normally remain in the family business is often sold for other uses.

To try to minimize the impact of estate taxes on a family business, some farmers seek professional estate planning advice. A good estate plan may require an accountant, an attorney, a financial planner, and an insurance agent. Establishing an estate plan costs money and takes time. It can be such a drain on the ongoing business and strain to family relationships that some farmers do not plan.

The Farm Bureau has long called for the elimination of estate and gift taxes. If this is not feasible, modifications are needed to reduce the burden on family farms and ranches. Farm Bureau supports increasing the current $600,000 exemption to $2 million and indexing the $2 million for inflation. Because land is not easily gifted in small blocks, we recommend that the yearly gift allowance be increased to $50,000.

We support unlimited use valuation under section 2032A and believe that cash leasing should not trigger recapture. Targeted tax relief for small businesses should be enacted, and estate taxes should be deferred until a family farm is sold by the heirs. Farm property that is restricted by a voluntary conservation easement should be exempt from estate taxes.

The capital gains tax is another tax that impacts land use. Many farmers and ranchers nearing retirement or in retirement are interested in selling land to younger farmers and ranchers, including family members. The current 28-percent capital gains tax discourages land transfers. Rather than selling farmland to the next generation, land is often held by the older generation until death and then becomes subject to estate taxes. My personal situation illustrates this point.

I grow crops and raise livestock on the farm next door to ours which is owned by my 90-year-old uncle. Both he and I would like to see that ground remain as farmland, but he is reluctant to sell it to me because of the capital gains tax. He purchased the ground during the thirties for around $100 an acre, and today it would be worth several times that if it were sold for development. Unless capital gains taxes are reduced, it is very likely that my uncle will hold his farm until he dies. I do not know if my cousins will be willing to rent or sell the land to me for farmland when they can sell it to a developer for much more.

As with the estate and gift tax, Farm Bureau supports eliminating the capital gains tax. If that cannot be done, we recommend a maximum rate of 15 percent and indexing assets for inflation. Another good option would be to allow retiring farmers and ranchers to sell land and put the money into a pretaxed IRA-type account.

Farm Bureau recommends several additional tax law changes that we believe would help maintain adequate farmland for future generations. Tax incentives should be provided for expenses required to meet mandated environmental policies. There should be tax deductions for contributions of voluntary easements. Bond rules should be changed to localize the definition of a first-time farmer and to allow loans to those purchasing farmland from family members.

More information on these proposals is contained in my written statement.

Finally, it is important to point out that the amount of taxes that farmers and ranchers pay in operating their businesses has an indirect impact on land use. The larger the business tax burden, the more likely farmers are to stop farming and that farmland will be converted to other uses.

In conclusion, Farm Bureau recommends that the Tax Code should be changed to minimize the impact on land use decisions made by farmers and ranchers. Farm Bureau's priorities are repeal or modification, if repeal is impossible, of estate taxes and capital gains taxes.

Thank you.

[The prepared statement and attachment follow:]

STATEMENT OF
THE AMERICAN FARM BUREAU FEDERATION
PRESENTED BY
A. I. (IRV) BELL, PRESIDENT
OHIO FARM BUREAU FEDERATION, INC.
TO THE
HOUSE WAYS AND MEANS COMMITTEE
SUBCOMMITTEE ON OVERSIGHT
REGARDING
THE IMPACT OF TAX LAW ON LAND USE

July 16, 1996

Thank you for the opportunity to testify at this hearing on the impact of tax law on land use. My name is A. I. (Irv) Bell. I, along with my wife, Jean, and son, Matt, operate a feed grain, hog and beef farm in Muskingum County, Ohio. I serve as the president of the Ohio Farm Bureau Federation.

The American Farm Bureau Federation's interest in tax policy and its impact on land use is keen. Production of food and fiber by farmers and ranchers requires the use of large amounts of land. Roughly 43 percent of the land in this country is farm and ranch land. When the lands owned by federal and state governments are subtracted, farm and ranch land account for almost 70 percent of the privately-owned land.

Chairwoman Johnson, when you announced this hearing, you made a very important statement, "A number of provisions of current law have both intended and unintended consequences for land use." While public policy is usually made with the intent of doing good, often little thought is given to the "unintended consequences." Our comments will address both intended and unintended consequences of the current tax system.

Federal Estate Taxes

At the top of the list of concerns of farmers and ranchers about unintended consequences of the current tax system is the federal estate and gift tax. Farms and ranches are ongoing businesses. Many of these businesses are multi-generation family businesses. The death of one member of the business can directly impact the ability of remaining members of the business to carry on operations after paying estate taxes. Land that would normally remain in the family and be devoted to agricultural production is then available to be put to other uses. Thus, the current federal estate tax law has, at times, the unintended consequence of forcing family-owned farms out of business and possibly shifting agriculture land to other uses.

Owners of these multi-generational farms and ranches often seek legal advice for estate planning to structure their financial assets and farming and ranching operations to minimize the estate tax consequences of the death of a member of the business. These actions are costly and may reduce the economic efficiency of day-to-day operations. Land is not easily gifted in small blocks to avoid the gift tax on yearly transfers, therefore, limiting the usefulness of gifting as an estate planning tool.

Farm Bureau policy has long called for the elimination of estate and gift taxes. This would be the simplest, cleanest approach to create more economic efficiency. If elimination of the estate and gift tax is not politically feasible, there are ways to lessen the unintended consequence of forcing farmland to be sold and possibly shifting to a different use.

The current per person exemption for assets in an estate is $600,000. This exemption amount was last changed in 1987. Farm Bureau policy calls for increasing that exemption to $2,000,000 per person. Exact figures are not available, but it is a reasonable estimate that 95 percent, and perhaps as many as 98 percent, of the farmers and ranchers would be exempt from estate taxes if the per person exemption was increased to $2,000,000 and then indexed for future changes in the overall price level. These farms could then be kept in the family and continued as ongoing businesses.

Another way to lessen the potential for the estate tax to force a change in land use is through special-use assessment under section 2032A. This provision allows for land to be valued for estate tax purposes at its agricultural value rather than its market value. Current law limits the special use evaluation to a reduction in value of $750,000. Removing the limit, or at least increasing the minimum, would reduce the potential for land to change uses to meet the cost of estate taxes, especially near large urban areas and around protected areas such as national parks. Cash leasing of farmland should be allowed under the special use evaluation.

Many other approaches could be used to help lessen the unintended impact of estate taxes. Targeted estate tax relief for small businesses should be enacted and estate taxes should be deferred until a family farm is sold by the heirs. The yearly gift allowance should be increased to $50,000 per year so that land could be transferred before the death of the owner. Farm property that is restricted by a voluntary conservation easement, while actively farmed by the heirs, should be exempt from estate taxes. These would all lessen the sting of the current estate tax system, but they would make a complicated tax system even more complex.

The best economic reform would be to repeal the estate and gift tax. The second best would be to increase the personal exemption to the point that most farms and ranches would not be adversely impacted by the estate tax. The third best solution is to expand the number of ways that estate taxes can be reduced or delayed. If tax reform is to truly make the tax system simpler and reduce the unintended consequences, eliminating the estate and gift tax is the best option.

Capital Gains Taxes

The capital gains tax is another tax that has unintended consequences for land use and is closely tied to estate and gift taxes. The capital gains tax is a tax on asset transfers from one form to another, such as from farm land to certificates of deposits in a bank. The tax can be avoided by simply not making the asset transfer.

Many farmers and ranchers nearing retirement or in retirement are interested in selling land to younger farmers and ranchers, including family members involved in the farm or ranch operations. The current 28 percent capital gains transfer tax is a large impediment to taking such action. Rather than making an orderly transition of land ownership from one generation to the next, the land is often held by the older generation until death and then caught in the estate tax web discussed earlier.

Part of the problem with the capital gains tax is that it is a tax on the total dollar gain in value, including the portion of the gain that simply reflects the change in the overall price level for the economy as a whole. For example, farmland is often held for 30 years or more. Over the last 30 years, the overall price level as increased by roughly three times. Land valued at $500 per acre in 1966 would have to sell for $2,000 per acre in 1996 for it to have the same purchasing power as the $500 had in 1966. Any increase beyond the $2,000 would be the "real" gain in the value of the land. Capital gains taxes are paid on the entire increase in the value of the land, not just on the real gain. Once again, this law leads to economic inefficiencies and unintended consequences.

As with the estate and gift tax, the best policy reform approach would be to eliminate the capital gains tax. If that cannot be done, the gain should be indexed for the change in the overall price level and the real gain taxed at a lower rate of 15 percent. Another option would be to allow retiring farmers and ranchers to sell land and put the money into an IRA-type account and pay taxes when the money is withdrawn from the account. This would be a positive economic incentive leading to a positive intended outcome.

All of these approaches would allow for an orderly transition from one owner to another and increase the potential for land to remain in production agriculture rather than be shifted to other uses.

Tax Policies With Positive Intended Consequences

Chairwoman Johnson, as you noted in your comments in announcing this hearing, you are also interested in exploring tax policies that would have a positive impact on maintaining current land uses. There are several policies that would have a positive impact on farm and ranch lands.

TAX INCENTIVES FOR ENVIRONMENTAL MANDATES

Tax incentives should be provided for expenses required to meet mandated environmental policies. For farms and ranches with slim operating margins, mandated environmental expenses can turn operating profits into operating losses. If these losses continue for a few years, selling the land may be the only option for survival. Other farmers and ranchers are reluctant to assume the risk of expenses to meet the environmental mandates on the land. Thus, selling for non-production agriculture uses may be the only viable option. Providing tax incentives should help meet environmental policy goals while keeping land in agriculture, a positive intended consequence.

INCENTIVES FOR VOLUNTARY CONSERVATION EASEMENTS

Tax deductions for contributions of voluntary easements is another way to meet environmental policy goals while keeping land in agricultural uses. The easement could be to a public agency or a private conservation group.

PRIVATE ACTIVITY "AGGIE" BONDS

Several state governments have provided programs for "aggie bonds" that are used to help beginning farmers and ranchers purchase existing operations. Because of current federal rules for tax status of the bonds, they cannot be used for sales from one family member to another. As noted earlier, multi-generational family farms are common and transferring assets from one generation to the next is a big problem under the current tax code. This change would allow more land to stay in the family and lessen the chance that the land would become available for purchase for non-agricultural uses.

RISK MANAGEMENT ISSUES

Farmers and ranchers must deal with volatile income swings that result from unpredictable weather and markets. Tax code provisions that allow the matching of expenses with income are of great help. Cash accounting is an important financial management tool. Income averaging and IRA-type accounts that allow farmers and ranchers to defer income would also be of benefit. Also helpful would be changes in the tax treatment of disaster losses and control over the timing of tax payments during and after periods of natural disasters. Repeal of the alternative minimum tax would simplify the tax system for farmers and ranchers and allow them to more effectively manage their tax burden.

Many other tax law changes would help to maintain farmers and ranchers on the land and reduce the potential for the land to shift to other uses. Two Farm Bureau priorities are allowing for the full deductibility of health insurance premiums paid by the self-employed and increasing the amount that small businesses can expense each year. Annual expensing of preproduction expenses should also be allowed.

Implications for Future Tax Policy

This subcommittee faces a major challenge in considering the impact of federal tax policy on land use. Current tax law has a major impact on land use because the overall tax load is large enough to cause land owners to seek legal means to reduce that tax load. Farmers and ranchers whose families have worked hard to accumulate assets in land do not want to pay confiscatory tax rates. Thus, they seek alternatives that may directly impact land use.

Two choices are available to deal with these problems. One option is to continue to add features to the current tax system to try to offset the negatives in the system. We have proposed some ways to do that for issues of particular concerns to farmers and ranchers.

The other option is to give up the idea of applying another batch of bandages to a troubled system and to start working toward reform of the entire federal tax system. We have made some suggestions for that approach as well.

We applaud the subcommittee for recognizing that inactivity is not a realistic option and encourage changes that will lead to either more positive intended consequences or less unintended consequences.

Thank you.

Agricultural Tax Legislation
Supported by Farm Bureau
In the
104th Congress

H.R. 12	American Farm Protection Act of 1995; allows farm property that is voluntarily restricted by a conservation easement to be exempt from federal estate taxes while actively farmed by heirs
H.R. 41	provides farmers and agribusiness with a 15 percent tax credit for capital expenses incurred in complying with federal, state and local environmental laws
H.R. 89	Family Farm Tax Relief and Savings Act; allows farmers, in contemplation of retirement, to invest proceeds from asset sales in an individual retirement account with taxes due only when funds are withdrawn
H.R. 501	provides that certain cash rentals of farmland will not cause recapture of the special estate tax valuation under section 2032A
H.R. 520	increases the maximum benefit under the special estate tax valuation rules to $1.5 million
H.R. 844	Farmer Retirement Security Act; allows farmers, in contemplation of retirement, to invest proceeds from asset sales in an individual retirement account with taxes due only when funds are withdrawn
H.R. 864	American Farm Protection Act of 1995; allows farm property that is voluntarily restricted by a conservation easement to be exempt from federal estate taxes while actively farmed by heirs
H.R. 1298	provides that certain cash rentals of farmland will not cause recapture of the special estate tax valuation under section 2032A
H.R. 1408	allows farmers and ranchers the option to count income from crop insurance proceeds and disaster payments in either the year of the disaster or the following year
H.R. 1588	expands the applicability of special tax rules governing the tax treatment of livestock sold to include all types of natural disasters, not just drought
H.R. 2078	lowers excise tax on draft cider from the higher wine rate to the lower beer rate
H.R. 2190	Family Business Protection Act of 1995, targets estate tax relief to family businesses by forgiving estate taxes on family business assets provided the family business continues to operate
H.R. 2218	Farmland Preservation Act of 1995; allows farm property that is voluntarily restricted by a conservation easement to be exempt from federal estate taxes while actively farmed by heirs
H.R. 2676	increases the opportunities for farmer owned cooperatives to own facilities that process and refine products produced by members by allowing corporations that sell such facilities to a qualifying farmer cooperative to defer the gain as long as the proceeds from the sale are reinvested
H.R. 3124	increases the annual expensing allowance for small businesses rom $17,500 to $50,000
H.R. 3251	Aggie Bond Improvement Act; changes the federal laws to allow beginning farmers to purchase land from family members and customizes the definition of a first-time farmer by establishing standards on a county specific basis

H.R. 3550	would allow the self-employed, in contemplation of retirement, to invest proceeds from asset sales in an individual retirement account with taxes due only when the fund are withdrawn
H.R. 3559	would allow farmers to place an amount equal to their 1996 FAIR Act market transition payment, or $40,000 whichever is less, into an income tax deferred account called a "Farmer IRA"
H.R. 3729	allows farmers to deduct a percentage of expenses incurred to cultivate, maintain and develop replantings made because of natural disasters, i.e. irrigation equipment, trellises

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Chairman JOHNSON. Thank you very much, Mr. Bell.

This is to the whole panel. Is the loss of open space a national problem, or is it a regional problem?

Ms. HOCKER. Madam Chair, I would be glad to take a first crack at that. I think it is clear that it is a national problem. It isn't limited to regions alone.

We are seeing, for example, the growth of land trusts in response to the loss of open space happening all across the country. They used to be limited to the Northeast and the east coast. Now we are seeing land trusts growing rapidly in the Southeast, in the upper Midwest, Northwest, in the west coast, Southwest, everywhere, and I think that that is because—I know that is because—the loss of open space is a national problem.

Chairman JOHNSON. I am thinking about the restrictions in the Houghton-Payne bill and other such ways of targeting the benefits, and I am wondering if the land trust mechanism is capable of handling the problem in some areas, but not in others; whether a targeted bill would clearly be a step forward, but would it be an adequate response?

Ms. HOCKER. Well, the answer is that the kinds of incentives that we are talking about ought to apply, in an ideal world, to every piece of land that is valuable to the public for conservation and is in danger of being lost to that purpose. In the real world, unfortunately, you do what you think can best be done and apply limitations accordingly.

Chairman JOHNSON. Mr. Lindstrom.

Mr. LINDSTROM. Madam Chairman, I would agree with what Ms. Hocker said. I would add, though, I think in our conversations with a number of people, there is somewhat of a misconception about the extent to which the American Farm Protection Act actually does apply.

If you take a look at a map that has been produced by the Department of Commerce, it shows metropolitan statistical areas, and then you take—and basically a metropolitan statistical area is an area that has an urbanized area of roughly 50,000 or more people, and it includes the entire county boundary surrounding that area.

So you can imagine, if you took that outer boundary and added 50 miles to it, that you pick up a considerable amount of land, and I know in Congressman Laughlin's district, while it looks as though he is pretty far removed from metropolitan areas, because of the way that "metropolitan area" is defined by the Department of Commerce, and then adding the 50-mile radius really picks up a considerable amount of land. And certainly studies done by the American Farmland Trust had indicated that some of the best farmland in the country, and that which is under the most significant pressure, is within those radiuses that have been proposed in the bill.

So while it would be ideal to cover the entire country, we think that the metropolitan statistical area is a reasonable basis to start from.

Ms. HOCKER. Madam Chairman, if I may add, these limitations apply in the American Farm Protection Act, but many of the other incentives that we have proposed would not be so limited, and this is among the reasons that we are proposing them. We think that land conservationists need a whole range of tools to protect land.

Chairman JOHNSON. Thank you.

Mr. Zimmer.

Mr. ZIMMER. Thank you, Madam Chair.

I would like to ask the panel, starting with Ms. Hocker, whether, based on your practical experience in land preservation, you think that the two pieces of legislation that I have introduced, one to allow the payment of land in lieu of cash for estate tax liabilities and the other to eliminate the bargain sale treatment of below-market sales of conservation easements, would have a practical impact on the behavior of individuals and would actually result in a substantial preservation of open space.

Ms. HOCKER. The answer to both questions—the answer for both pieces of legislation is yes. The ability of heirs to make decisions about the land that the decedent was unable or didn't know enough to make is absolutely critical, and I know of situations where heirs would have probably made the decision to protect the land or to donate an easement to protect the land if that option had been available.

I would add that not only would your proposal for a tax credit for land that is donated or easements that are donated after death be critical for lands that are the highest value, but even if it were a tax deduction—the ability of an heir to make a donation of land or an easement for conservation and get a tax deduction, rather than a credit from the taxable estate—it would be a benefit; heirs would make that change.

Your piece of legislation on bargain sales will be increasingly important, I believe, because as those landowners who are in a position to make a donation of land or an easement have done so or decided not to and have made their decision, there are more and more landowners who cannot necessarily afford to make an entire gift wanting to protect their land. For them, the bargain sale is a very good compromise. They make a partial gift, they get a partial donation, they also get some income; and I think that tool will be increasingly important to land protection. So that bill is also extremely important.

Thank you for introducing both.

Mr. ZIMMER. Thank you.

Mr. Lindstrom.

Mr. LINDSTROM. Congressman Zimmer, I agree with Ms. Hocker, and I would add that the region that the Piedmont Environmental Council serves is bordered almost along its entire nine-county length on the west by the Shenandoah National Park, which is one of the most heavily used parks in the United States, closer to more people than probably most any other national park, and I think that one of the concerns of the Park Service is how to protect that park. I think that the legislation that you have introduced, it certainly will be a significant additional tool for them.

Ironically, I will have to tell you that there is legislation afoot in the Congress that would freeze the boundaries of the park so that it could not even be expanded by the gift of land, and obviously that would be counterproductive to the effort that you have been very appropriately pursuing.

Mr. ZIMMER. Thank you.

Chairman JOHNSON. Mr. Laughlin.

Mr. LAUGHLIN. Thank you, Madam Chairwoman.

Mr. Lindstrom, I appreciate your explanation. It does demonstrate the broad expanse of the bill, and I understood that, other than just San Antonio or Houston or the very large cities. But again, we have some land that has artificial values along our interstates that would not, and I can think of one county along Interstate 10 that none of these definitions would reach, and it concerns me. That is why I mention it.

The staff gave me a question for you, Mr. Lindstrom, but apparently an answer was given earlier about the types of property that are eligible for exclusion under the American Farm Protection Act, that apparently the answer should have been broader. Is it broader than just farm- and ranchland, or is it confined to just farm- and ranchland?

Mr. LINDSTROM. No, Congressman. It is broader than that. The American Farm Protection Act qualifies the land under an existing section of the Tax Code, which is section 170(h), which lists a number of categories that, if you have land which falls under one of those categories, it will qualify not only for a tax deduction under existing law but also for the exclusion provided by this proposal.

It would include certainly prime farmland and ranchland and forestland, but also it would include environmentally sensitive land, land that was a particularly important habitat for endangered species or for other flora and fauna. And so it is much broader than simply actively farmed land or forested land.

Ms. Hocker may want to add to that.

Ms. HOCKER. I think you have covered it.

Mr. LAUGHLIN. Ms. Hocker, I appreciate your comments about the separation of property. It reminds me, when I met with some members of the Russian duma, they did not understand the ownership being different from the surface and below the surface.

Madam Chairwoman, we do in Texas, and all I can say is, I wish I owned a lot more of the under-the-surface than the surface, since I don't own much of either.

Ms. Hocker, tell us what the problem is, and how extensive you view it to be, and what you recommend to change that.

Let me just say to you that while I come from an area that primarily is oil and gas production and some sulfur—and that has just about gone away—coal mining has become more prevalent in recent years in my part of Texas, and, frankly, the strip mining that we think about being so horrible, there are requirements now by some landowners that that land be rehabilitated. And I have a friend who has one of those ranches that they have taken the coal out. Frankly, the surface looks better and he thinks it is better than it was before the coal miners.

Can you elaborate some on what the problems are from your viewpoint and some solutions?

Ms. HOCKER. Yes. Thank you, Congressman, for the opportunity to do that, because a very obscure point of the law is holding up a number of donated conservation easements currently. The law governing the deductibility of conservation easements allows for the donation of an easement over land where the surface and subsurface rights have been separated, where the owner of the surface doesn't own all of the mineral rights.

If the rights were first separated before 1976, and if the owner can show that the likelihood of surface extraction is so remote as to be negligible, an easement that is donated on property where the mineral rights were first severed from the surface rights after that date in 1976, it is extremely difficult to give a qualified easement over such property.

We don't see any reason for having an artificial date in there. It is important to be able to show, of course, that the surface is unlikely to be disturbed, because taxpayers don't want to grant tax incentives to landowners on land where the surface will be disturbed by major mining, perhaps.

But there is no reason to have an arbitrary date, and for land where the rights were first separated before that date a deductible conservation easement property is eligible, and for land where surface rights were separated from mineral rights after that, such easements are not eligible. It doesn't make any sense.

The solution simply is to eliminate, eliminate the date, and treat all land equally. If the rights are severed but the landowner can show that the likelihood of surface extraction is so remote as to be negligible, let those landowners donate conservation easements. It is simply a matter of removing the date from the current law.

Mr. LAUGHLIN. Madam Chairwoman, I see the red light is on, but I would like to ask Mr. Bell a question.

Chairman JOHNSON. Go right ahead.

Mr. LAUGHLIN. Mr. Bell, you may not be the first bona fide farmer that has been before this Committee, but my memory is, you are the first since I have been on it. So I want to ask you, if you could, from a farmer's viewpoint, tell us why the estate gift tax is such a problem for the agriculture community in preserving the valuable land for agriculture purposes from one generation to the next, particularly when we read from time to time that it is extremely difficult for a new generation of farmer to get into the agriculture business.

And also as part of your answer, if you could tell us whether there is anything, other than raising the estate and gift tax limitation or abolishing it, that would be better. In my opinion, these are the only major tax problems with preserving the property for agriculture purposes.

If you could offer the viewpoint of a farmer I would appreciate it.

Mr. BELL. If you don't mind, I would like to take the liberty to also talk about capital gains taxes and their ramifications.

Mr. LAUGHLIN. That was part of my question, because I said in addition to the estate gift tax.

Mr. BELL. Thank you.

As I sat and listened to my colleagues on the panel discussing the farmland trust issue, certainly we who are farmers appreciate that effort. My home State of Ohio is an agricultural State. But more than that, we are an industrial State, a highly populated State. Therefore, we have great interest in our State in terms of preserving farmland.

I relate back to your discussion and your questions about the 50-mile radius. I am one of those farmers who barely falls outside of that 50-mile radius.

Mr. LAUGHLIN. You need to move your farm then.

Mr. BELL. I need to move my farm. I have thought of that often. We are about 70 miles outside of Columbus. I would like to come back to what I mentioned about my uncle's farm before.

We farm several farms in our community. My son and I and a hired employee, we are farming a lot of land that a lot of farmers used to farm. Several of those farms, two of them, have been sold within the last year for development. This is a loss of open space. This is conversion of farmland to purposes that will never be open space again. We will never see farmland on those acreages again.

Again, citing my uncle's example, his farm has a basis of roughly $100 an acre. The capital gains would be huge if he were to sell it to me today.

Now, if he lets it go through probate and the basis is stepped up, his heirs, my cousins, will be the ones dealing with that. It will be their decision whether they want to see it remain as farmland and whether they and I can cooperatively come to an agreement that lets that happen.

In his specific example, the Federal estate tax, depending on how the land is valued at the time of his death may or may not be a huge problem. We know that capital gains, if he sold it to me today, would be a problem. But knowing what the market value of that land is, not for what I would call its best use, but for what real estate developers would call its best use, I could not possibly afford to pay to purchase that farm.

Mr. LAUGHLIN. It sounds from your answer, Mr. Bell, that your cousins or none of the children of your uncle who has the farm next door are interested in maintaining the family tradition of farming that particular property; is that correct?

Mr. BELL. No. If I were to poll them today—there are four of them—I think that they would say, "Yes, we want to see it kept as a farm."

Mr. LAUGHLIN. My question specifically: Would they, the individuals, farm it?

Mr. BELL. No, they as individuals are not interested in farming it.

Mr. LAUGHLIN. And I wanted that answer, because you almost went to the next one that I want to ask, and that is, is there a significant reason, from an agricultural viewpoint, to have property passed to someone other than a relative, either through, let's just say, sale, when the agriculture use is going to be maintained—using your cousins as an example of people who are not going to farm the property but would like to see it continued in a farm operation—to have some tax benefit to preserve that agriculture use, rather than in the instance—and I don't know your cousins, but I am going to talk about them.

Mr. BELL. That is fine.

Mr. LAUGHLIN. Perhaps sell it for real estate development as a supermarket or a mall or some other nonagricultural use.

Mr. BELL. Right. We don't know how this is going to play out. We have talked about it. To me, the logical thing would be for my uncle and me to agree on a fair market price for agriculture prior to his death. If he and I could come to that agreement, I would purchase it from him prior to his death. But the capital gains restriction probably will not let that happen.

Mr. LAUGHLIN. Mr. Lindstrom, the Houghton and Payne bill, I understood that use of the property was one of the considerations. Would Mr. Bell's family example fall within that bill where there wouldn't be the significant tax consequences if the property's use continued to be agriculture?

Mr. LINDSTROM. It would be protected under the American Farm Protection Act.

I would need to look at a map to see physically whether you are within that 50 miles of that outer boundary of the Columbus metropolitan area. But the way the American Farm Protection Act works, if Mr. Bell's uncle were to put a permanent easement on that land that restricted it to farm use essentially, that land under the Houghton bill would pass estate tax free.

Mr. LAUGHLIN. Even to a total stranger?

Mr. LINDSTROM. Even to a total stranger.

Mr. LAUGHLIN. The agriculture use would apply.

Mr. LINDSTROM. That is right. And that commitment to agricultural use, of course, would then continue under the terms of the easement regardless of who owned the land.

Mr. LAUGHLIN. I recommend, Mr. Bell, your organization, and other agricultural organizations, make as many Members of Congress aware of that benefit of the Houghton-Payne bill.

Thank you, Madam Chairman.

Chairman JOHNSON. I appreciate your questions. I did want to pursue one other issue with Mr. Bell.

Your testimony raised some problems of equal importance. These aggie bonds that you referred to and the restriction that they can't be used for the purchase by one family member of the farmland from another family member——

Mr. BELL. Madam Chairman, I confess I am not as familiar with that as I could be. Could we get that information to you on that?

Chairman JOHNSON. Those are the kinds we ought to look at. It is those kinds of little glitches in the law that really affect circumstances like yours. Many farmers are in those circumstances, where the land was divided by a preceding generation, and yet those who work the land end up doing the work and getting the benefit later on, and finally it has to be sold outside the family for tax reasons.

The other thing that interested me was the need for farmers to be able to manage their income differently in terms of IRA contributions. I think that is something we need to look at, and we may want to look at. It goes more to the income security issue than the conservation issue, but we may want to look at some parallel right for older farmers, particularly, who sell a principal residence or sell their farm, to have some exemption from capital gains.

I don't know what proportion of the farm community has been consistent about their Social Security. Do small farmers generally contribute to Social Security the whole 15 percent?

Mr. BELL. Yes, I would say so, yes, ma'am. I would totally concur and would really appreciate your saying that the interest of looking at an IRA-type investment for farmers is something that I as an individual and certainly we as an organization certainly support and would be very much interested in working with you in any way we could.

Chairman JOHNSON. Particularly farmers paying the 15 percent, probably not many of them are investing in IRAs. It may be possible to turn over some of those proceeds to an IRA. We are looking at some formula that provides fairness. Or maybe a combination of those things with the conservation concerns. I thank you very much for your testimony.

Ms. Hocker, over the course of evaluating initiatives, we hope to have the help of your organization since you are right here near us. We will certainly keep in touch with all of you as we move forward.

The next panel is Tamar Osterman, the director of government affairs for the National Trust for Historic Preservation; Richard Kelly from South Windsor, Connecticut, representing the National Association of Home Builders; and Bruce MacEwen, the vice president of taxation, Portman Holdings, L.P., Atlanta, Georgia, on behalf of the National Realty Committee.

We welcome you all. We will start with Ms. Osterman.

STATEMENT OF TAMAR OSTERMAN, DIRECTOR, GOVERNMENT AFFAIRS, NATIONAL TRUST FOR HISTORIC PRESERVATION

Ms. OSTERMAN. Thank you, Madam Chairman. My name is Tamar Osterman. I am director of government affairs for the National Trust for Historic Preservation.

The National Trust is pleased to be here before the Subcommittee today. We commend the Chairman for holding a hearing on the subject of the impact of the Federal Tax Code on land use decisions. The National Trust has set as one of our principal goals to reverse the impact of decline and disinvestment in historic resources and historic communities. The Internal Revenue Code provides tools to address these problems with which I have dealt at length in my written testimony, and also an excellent opportunity in the form of legislation pending before Congress.

Between 1981 and 1987, the historic resources of older communities, particularly in urban areas, experienced no less than a renaissance. During that time, the historic rehabilitation tax credit stimulated nearly $12 billion of reinvestment in cities and towns across the country. As a result of this powerful incentive, citizens rescued landmark railroad stations, hotels, schools, and office buildings from demolition. Historic preservation fueled the back-to-the-city movement of the seventies and eighties, bringing new life to warehouse districts, waterfronts, and downtowns that were the tattered remnants of our Nation's history and settlement.

In Connecticut alone, the rehabilitation tax credit generated an estimated $213 million in investment, creating 8,000 jobs and the rehabilitation of 2,300 housing units. This economic activity, which often spurred reinvestment in surrounding areas, has been greatly diminished since the tightening of the passive loss restrictions in the 1986 tax act.

Today, private investment and preservation projects under the credit amounts to less than 20 percent of pre-tax act activity. Nonetheless, the investment tax credit continues to be an important tool for historic preservation and community revitalization, particularly when it is combined with other government and private resources, such as the low-income housing tax credit. In fact, rental housing has been the single most important use for buildings rehabbed under the investment tax credit. But older neighborhoods, neighborhoods of residential homeowners, still need the tools to address the blight and abandonment that threaten entire communities.

For 30 years, from milltowns in New England and the South, to the industrial cities in the Midwest, historic communities have been in a spiral of decline and decay. Left behind in the surge to the suburbs and exurbs is an inventory of sound housing stock and older commercial buildings, much of which has historical or architectural significance.

And while this disinvestment continues to occur, while we continue to abandon quality buildings and already paid for infrastructure, the surrounding countryside is fast disappearing under new tract housing development.

The back-to-the-city movement of the seventies and eighties was really a back-to-the-historic-neighborhood movement. Today, more than ever, historic cities, towns, and communities need an incentive for home ownership. As we saw with the commercial rehab tax credit, when the incentives are in place, the response can be tremendous.

To my right are a couple of charts which we brought just to indicate the breadth of the historic resources in the country. The one is the cumulative number of National Register listings, which is 64,000, and then a chart that shows contributing resources in historic districts, 8,700 historic districts throughout the country and in each State.

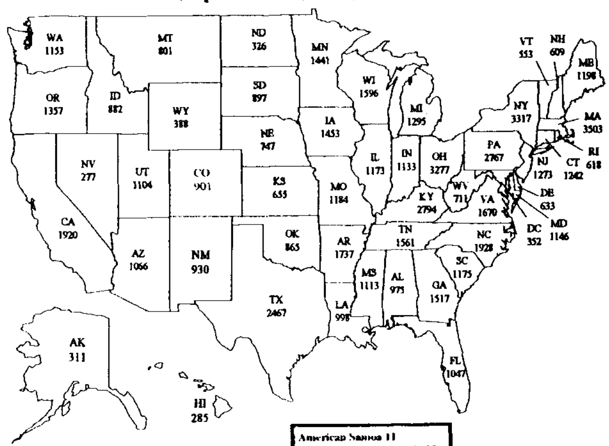
[The following was subsequently received:]

National Park Service
Heritage Preservation Services Program
Branch of State, Tribal, and Local Programs

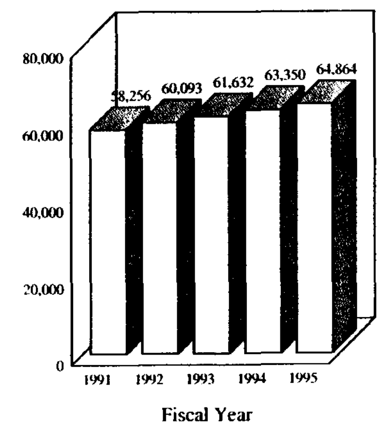
THE NATIONAL HISTORIC PRESERVATION PROGRAM AT A GLANCE

National Register of Historic Places

Cumulative Number of National Register Listings (September 30, 1995)

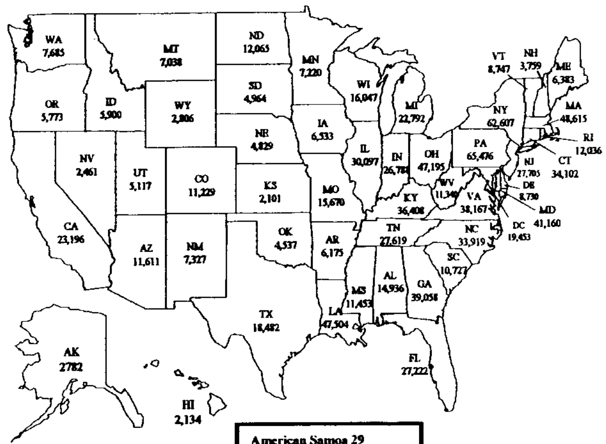


National Register Listings (FY 1991--1995)



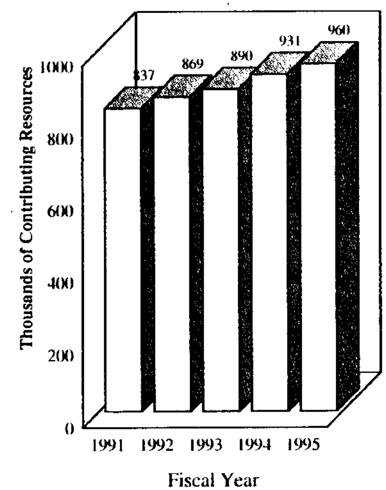
National Register of Historic Places

Cumulative Number of Contributing Resources Listed on the National Register (through FY 1995)



American Samoa 29
Fed. States of Micronesia 169
Guam 160
Marshall Islands 35
N. Marianas 203
Republic of Palau 6
Puerto Rico 586
Virgin Islands 1,607

Contributing Resources on the National Register (FY 1991 – 1995)



For more information on the National Register of Historic Places, contact the National Park Service at (202) 343-9536

H.R. 1662, the Historic Homeownership Assistance Act, sponsored by Representatives Shaw and Kennelly, is an effective answer to the need for an incentive for historic home ownership. This legislation calls for a minimum of government involvement and a maximum of private initiative.

H.R. 1662, which I thank the Chairman for cosponsoring, would provide a 20-percent credit for qualified rehab expenditures to homeowners who purchase and rehabilitate a historic home for use as a principal residence. The maximum credit allowable would be $50,000 for each residence. But since this proposal is intended not only to foster home ownership and encourage rehabilitation of deteriorated buildings, but also to promote economic diversity and increase local tax revenues, individual taxpayers would be eligible for the credit without regard to income.

The credit would be available to homeowners in condominiums and cooperatives as well as single-family homes. It could be used by the do-it-yourself rehabber or someone who purchases a home rehabilitated by a nonprofit or for-profit developer. In that case the credit would accrue not to the developer, but would be passed through to the purchaser of the home. In this way the historic homeowner tax credit could be used to help offset the cost of purchasing a home.

As with the current credit, rehabilitation must be substantial: The greater of $5,000 or the adjusted basis of an eligible building. However, if the property is in a census tract targeted as distressed for mortgage revenue bond purposes, or in an empowerment or enterprise zone, just a $5,000 expenditure is necessary.

This provision is meant to make the credit usable in situations where the building has a much higher value relative to the value of the underlying land which is often true in deteriorated inner-city neighborhoods. It is a common misperception that historic neighborhoods contain only wealthy people and grand residences. The truth is that the majority of historic neighborhoods, because they are in the older areas of towns and cities, are home to people of modest means. In fact, almost one-third of all historic districts contain or are located in census tracts with poverty rates of 20 percent or greater.

Because many homeowners might not have sufficient tax liability to utilize this credit, this legislation creates a mortgage credit certificate program. Instead of a tax credit that he could not use, a home buyer could receive a certificate in the face amount of the credit. The home buyer would transfer the certificate to his mortgage lender in exchange for a reduced interest rate on his mortgage. The bank could then use the certificate to reduce its own Federal income tax liability.

The revenue implications of H.R. 1662 would be modest. The Joint Committee on Taxation has estimated the revenue loss to the Treasury at $239 million over 5 years. This is largely due to the limited universe of eligible structures, which includes buildings listed on the national or State and local registers and contributing buildings located in national, State, or locally designated historic districts. The Park Service estimates that there are over 800,000 buildings that would qualify for the credit.

In closing, Madam Chairman, I want to note that the economic benefits of historic rehabilitation, while considerable and well documented, are not the only reason why communities pursue historic preservation as part of an overall revitalization strategy. The social, cultural, and historical benefits of rehabilitation have been verified repeatedly by addressing blight and abandonment and by restoring the tangible markers of a community's history, hope and pride can be restored as well as buildings. The results, to which many neighborhood residents can testify, include safer streets, more livable neighborhoods, and a social cohesiveness which are all too often absent in today's society.

Thank you, Madam Chairman.

[The prepared statement follows:]

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Testimony of
Tamar Osterman, Director of Government Affairs
National Trust for Historic Preservation
before the
Subcommittee on Oversight
House Committee on Ways and Means
July 16, 1996

Madame Chairman, Members of the subcommittee, thank you for the opportunity to appear today to testify on the impact of federal tax law on land use. The National Trust for Historic Preservation is a non-profit organization with more than 265,000 members, chartered by Congress to promote public participation and education in historic preservation and to engage the private sector in preserving our nation's heritage. As the leader of the national historic preservation movement, the National Trust is committed to saving America's diverse historic resources and to preserving and revitalizing communities nationwide.

The Internal Revenue Code contains numerous provisions that directly and indirectly affect land use. Therefore, I will focus my testimony on those provisions which are particularly relevant to historic resources and historic communities.

I also want to present the National Trust for Historic Preservation's views on a very important historic preservation tax proposal, of which the Chair and 14 other members of the Ways and Means Committee are co-sponsors: H.R. 1662, legislation to provide a tax credit for qualified rehabilitation expenditures of a historic property as an owner-occupied home.

Background

Over the decades since World War II, a combination of social and economic forces, abetted in no small measure by government policies and programs, has produced a steady migration of population and business activity from large and small urban areas. Left behind in the surge to the suburbs and exurbs is an enormous (but dwindling) inventory of sound housing stock and older commercial buildings, much of which has historic or architectural importance, or both. Investment decisions have been greatly influenced by substantial subsidies provided for low-density, land consumptive development, particularly in the form of highway construction, and the demolition of existing building stock through the well-intentioned, but ultimately catastrophic bulldozing of established urban centers and neighborhoods under federal urban renewal and highway construction programs. The result has been a spiraling cycle of blight, crime, and decline in urban tax base and services.

Tax incentives cannot reverse demographic trends, restore fiscal solvency to cities and towns, fight crime, or improve education. What they can do is provide, at the margin, a salutary corrective to the institutionalized bias toward out-migration of population and business activity and the consumption of open space at the expense of reinvestment in declining areas that are already equipped with buildings and infrastructure. In addition, where incentives are linked to the appropriate rehabilitation and reuse of buildings of historic or architectural value, the benefits of historic preservation--both tangible and intangible--can also be realized.

The economic benefits of reclaiming these buildings and the existing infrastructure which supports them are impressive. According Donovan D. Rypkema, author of The Economics of Historic Preservation, for every one million dollars spent on rehabilitation instead of on new construction, $120,000 will initially stay in the community; five to nine more construction jobs will be created; and total household income in the community will increase by $107,000. Building rehabilitation outperforms new construction in the number of new jobs created, the increase in local income, and the impact on all other industries.

But while the economic benefits of historic rehabilitation are considerable, they are by no means the only reason why communities pursue historic preservation as part of an overall revitalization strategy. The social, cultural, and historical benefits of preserving both architectural gems and the ordinary places where ordinary people lived and worked have been verified repeatedly. By addressing blight and abandonment, and by restoring the tangible markers of a community's history, a community can restore hope and pride as well as buildings. The results, to which many neighborhood residents can testify, include safer streets, more livable neighborhoods, and a social cohesiveness that is all too often absent in today's society.

Provisions in the Internal Revenue Code which support the goals of historic preservation

Before turning to the provision which has had the greatest benefit for our country's historic resources, the historic rehabilitation investment tax credit, I would like to cite three other provisions in the code by which historic preservation benefits: the deductibility of interest on mortgage revenue bonds; and property owner income and estate tax exemptions for historic preservation easements held by qualified organizations.

Historic preservation easements provide key incentives for property owners to protect the facade and surroundings of historic structures or historic land areas from inappropriate development while retaining the property in private ownership. For example, the National Trust is in the process of acquiring an historic easement on the Clark-Ward House, an 18th century home listed on the National and Connecticut Registers of Historic Places, which is the oldest house in West Haven, Connecticut. The neighborhood surrounding the house is undergoing a transition from residential to commercial use, and the house itself was threatened by encroaching development. The historic easement will protect the Clark-Ward House in perpetuity, which has spurred a local non-profit organization to acquire the house in order to create a museum and an educational center for school children to learn about the history of the area.

As I noted earlier, the decline and disinvestment of our nation's older communities puts their historic resources, and the neighborhoods themselves, at grave risk. By allowing the interest paid on mortgage revenue bonds to be tax-deductible, the federal government is providing a significant incentive for reinvestment in older neighborhoods, thereby assisting states and localities in their efforts to target growth and development. Last week, Maryland Governor Parris Glendening announced a six year, $72 million state-wide neighborhood conservation effort, aimed at revitalizing Maryland's older communities and encouraging investment in already built up areas. This initiative will be complemented by more flexible eligibility standards for $40 million in MRB-financed mortgages for Baltimore County and other older Maryland suburbs, in order to attract homebuyers to those areas. In announcing this effort, Governor Glendening said he intends to continue using such incentives to help localities manage growth.

<u>Historic Rehabilitation Investment Tax Credit:</u>

Since 1976 the Internal Revenue Code has contained incentives to stimulate capital investment in income-producing historic buildings and the revitalization of historic communities. These include a 10 percent credit for the substantial rehabilitation for nonresidential purposes of buildings built before 1936 and, more significantly, the Historic Rehabilitation Investment Tax Credit, which applies a 20 percent income tax credit to qualified rehabilitation expenses on certified historic structures. Certified historic structures include properties listed in the National Register of Historic Places, or contributing properties within historic districts in the National Register of Historic Places, or located in federally-certified state and local districts. The effects of National Register listing are positive, by fact and by law. Listing does not give the federal government control over private property nor does it preclude demolition of historic properties by the federal government or private or other governmental owners. Register listing confers benefits and opportunities, such as eligibility for the historic rehabilitation investment tax credit.

From 1981, when the historic rehabilitation investment tax credit was adopted, until 1987, when changes made under the Tax Reform Act of 1986 took effect, the historic resources of older communities, particularly in urban areas, experienced a renaissance. Nationwide, the historic rehabilitation tax credit stimulated nearly $12 billion during that seven year period in the rehabilitation of historic buildings. As a result of this remarkable incentive, citizens across the country rescued landmark railroad stations (including Washington's Union Station), hotels (such as the Willard Hotel), schools and office buildings from decay and demolition. These restorations frequently catalyzed reinvestment in the surrounding neighborhood, thus adding value beyond that of the rehabilitation itself. Historic preservation fueled the "back to the city" movement of the 1970s and 1980s, bringing new life to abandoned and deteriorated warehouse districts, waterfronts, downtowns, and other remnants of an area's history and settlement which had previously been in tatters.

Connecticut has been one of the greatest beneficiaries of the historic rehabilitation tax credits. For the four years from Fiscal Year 1982 through Fiscal Year 1985, Connecticut ranked 11th in the number of approved rehab projects, and 12th in the amount of investment. In that time, 371 projects generated an estimated $213 million in investment, creating over 8,000 jobs and the rehabilitation of 2,300 housing units. Hartford was among the top 50 cities in the nation in the number of tax incentive projects. However, the impact of the historic rehabilitation tax credit was greatly reduced by the passive-loss and income restrictions imposed on it by the Tax Reform Act of 1986. Today, private investment in preservation projects under the credit amounts to less than one-fifth of what it had been in its heyday. Connecticut experienced a drop of 76 percent in use of the credit, with investment declining from $65.6 million in FY86 to $11.9 million in FY88.

Nonetheless, the historic rehabilitation investment tax credit continues to be an important tool for historic preservation, particularly when it is combined with other government and private resources. According to the National Park Service, in FY 1994 the program leveraged $483 million in private development activity nationwide at a cost to the federal treasury of approximately $97 million.

Many of these rehabilitations involve the conversion of historic structures, particularly schools and office buildings, into residential rental buildings, creating affordable housing in downtown areas. In fact, housing has been the single most important use for rehabilitated historic buildings under the preservation tax credit program. Since the program began, over 131,000 housing units have been rehabilitated and over 66,000 have been newly created. And with the reduced incentive to utilize the credit post-tax reform, many developers have generated necessary leverage by combining the Historic Rehabilitation Tax Credit with the Low Income Housing Tax Credit, which was created in the Tax Reform Act of 1986.

For example, the Dunbar Hotel was built as a first class hotel for African-Americans who had no comparable place to stay in Los Angeles in the 1920s. For the next thirty years, the Dunbar flourished, but by the 1970s decline and disinvestment in downtown Los Angeles had taken its toll and the historic hotel housed only a few transients. Using the Low Income and Housing Rehabilitation Tax Credits, the Dunbar Hotel was restored in 1989 as the anchor for revitalization of the larger neighborhood. Today, it consists of 73 low-income apartments, four commercial spaces, a museum, and a senior center.

The Need for a Historic Homeowner Tax Credit

Despite being significantly undercut by the Tax Reform Act of 1986, the existing historic rehabilitation tax credit is presently the most valuable tool available for incentivizing historic preservation. What we still lack are the tools to address the problems of blight and abandonment that threaten entire older neighborhoods and communities. Clearly, this is no time for massive government programs which might or might not be successful in helping to preserve these resources. What is needed is an incentive which will involve a minimum of government involvement and a maximum of individual initiative, one that is modest in cost and limited in scope but that can spark broad private activity. The National Trust believes that H.R. 1662, introduced by Representatives Clay Shaw and Barbara Kennelly, and co-sponsored by 74 House members, is a fair, feasible and effective answer.

H.R. 1662 is designed to work in a broad range of contexts; each community is likely to find its own applications. For example, in many of the small towns of New England and the Midwest, older housing that would qualify for the credit has suffered from blight and abandonment as the mills and retail businesses upon which those communities depended declined and closed. Enterprising developers could buy up abandoned homes, rehabilitate them so as to qualify them for the credit, and sell them to young families, passing on the credit to the purchaser. These families might prefer living in a renovated older home in town, with the amenities of an earlier era and the convenience of in-town living. The result would be new life for the town, new customers for the town's small businesses, and new tax revenues for the town's hard-pressed treasury.

At the other end of the spectrum, many cities, large and small, possess older office buildings that would qualify for the credit, but which can no longer attract commercial tenants. Many of these buildings are architectural assets, but without an economic function they are targets for the wrecking ball. However, a federal homeownership credit could make these buildings economically attractive to a developer who could rehabilitate them as residential condominiums. The developer would, in effect, be selling the unit along with the credit. In this way these buildings could be saved, and the homeowners attracted to them would provide new customers for local merchants and new taxpayers for the city.

Major Provisions of H.R. 1662

Rate of Credit:

The credit, which would equal 20% of qualified rehabilitation expenditures, would be available to homeowners in condominiums and cooperatives as well as single-family homes. It could be used by the do-it-yourself rehabber, or someone who purchases a home rehabilitated by a non-profit or for-profit developer. In the latter case, the credit would accrue not to the developer, but to the purchaser of the home.

Eligible Structures

The universe of buildings eligible for the tax credit is a limited one. Only buildings that are listed in the National Register of Historic Places, are contributing buildings in National Register Historic Districts or in nationally-certified state or local districts, or are individually listed on a nationally-certified state or local register would qualify. The National Park Service has estimated that slightly in excess of 800,000 buildings nationwide presently fall in those categories.

To insure that their historic character is preserved, buildings receiving the credit would have to be rehabilitated in accordance with the Secretary of the Interior's Standards for Rehabilitation. However, the bill provides that certification of compliance may be performed by states or even localities under cooperative agreements entered into with the Secretary of the Interior. In addition, the bill authorizes the states to charge processing fees, the proceeds of which would be used to fund the costs of processing the applications for certification.

Maximum Credit, Minimum Expenditures

The maximum credit allowable would be $50,000 for each principal residence, subject to Alternative Minimum Tax provisions. Any unused portions of the credit could be carried forward until exhausted. As with the current credit, rehabilitation must be substantial--the greater of $5,000 or the adjusted basis of an eligible building, with an excepti on for buildings in census tracts targeted as distressed for Mortgage Revenue Bond purposes under I.R.C. Section 143(j)(1) and Enterprise and Empowerment Zones, where the minimum would be $5,000. At least five percent of the qualified rehabilitation expenditures would have to be spent on the exterior of the building. In the event that the taxpayer fails to maintain his principal residence in the building for five years, the credit would be subject to ratable recapture.

Homeownership and Historic Preservation

Central to the American dream is the desire to own one's own home. But home ownership is more than just a personal goal; by giving residents a true stake in their community, it promotes the qualities of neighborliness needed to heal and revive threatened and decaying residential areas.

The existing federal tax credit for historic rehabilitation is not available to homeowners, but applies only to commercial property or other property held for the production of income. H.R. 1662 fills that gap. Moreover, because the tax credit that H.R. 1662 would create is limited to persons who occupy the building for which the tax credit is claimed as their personal residence, there are no tax shelters, no "passive losses" and no syndications. Further, since the proposed legislation is intended not only to foster homeownership and encourage rehabilitation of deteriorated buildings, but also to promote economic diversity among residents and increase local ad valorem real property, income, and sales tax revenues, individual taxpayers would be eligible for the credit without regard to income.

Opportunities for Low and Moderate Income Home Buyers

There is a widespread misperception that historic districts are places where only rich people live. While it is true that some of the better known districts on the National Register have been rehabilitated by or for affluent people, it is equally true that the older housing stock in the United States tends far more to be occupied by the poor than by the rich. Indeed, according to an analysis of 1990 census data, 29% of the 8,700 National Register historic districts lie within or contain tracts with poverty rates greater than 20%, a proportion found among Connecticut's 300 historic districts as well.

This legislation has been drafted to provide homeownership opportunities in rehabilitated historic buildings to Americans at all income levels. For those who do not have sufficient income to be able to use a tax credit, the bill creates a Historic Rehabilitation Mortgage Credit Certificate that can be used to reduce the interest rate on their mortgage loan. Instead of a tax credit that he could not use, a homebuyer could receive a certificate in the face amount of the credit. The homebuyer would transfer the certificate to the mortgage lender in exchange for a reduced interested rate on the mortgage loan. The bank could then use the certificate to reduce its own federal income tax liability, subject to Alternative Minimum Tax restrictions, passing along the benefits to the home buyer by reducing the interest rate.

A Hypothetical Example

Consider, as an example, a hypothetical home rehabilitated by a developer which qualifies for the credit. Assume that the home has a selling price of $150,000 and contains $100,000 in qualified rehabilitation expenditures. The credit on this home is $20,000 (20% of $100,000). This would more than cover a down payment of 10 percent on the home. In this case the credit would have the effect of reimbursing the home purchaser for the down payment. Although this example involves a developer, the credit could also be used by an individual homeowner to help defray the cost of rehabilitating his current or newly-purchased residence.

Costs and Benefits

The revenue implications of H.R. 1662 would be modest. The Joint Committee on Taxation has estimated the revenue loss to the treasury at $446 million over a seven year period. Nevertheless the National Trust believes this proposal can make a real difference in communities all across the county--from decaying small towns to threatened big-city neighborhoods. This view is shared by the United States Conference of Mayors, the National Association of Home Builders, the Delaware Bankers Association, as well as preservation, economic development, and citizen groups across the country. By providing an incentive for Americans at all income levels to invest in the rehabilitation of deteriorated buildings and become home owners in older neighborhoods and communities, a historic homeowner tax credit can provide the following benefits:

- saving invaluable historic resources, which would otherwise be lost through decay, abandonment and demolition.

- stabilizing and rescuing endangered communities through the infusion of new home owners, who will make a commitment to the enhancement of community life through their purchase of a home.

- providing cities and towns with the chance to strengthen their tax bases by attracting middle-income and more affluent residents.

- creating jobs and stimulating economic activity in areas where economic opportunities are scant.

When preservation begins in a community, good things follow. H.R. 1662 is not a cure-all for ailing communities. Change for the better, if it is to come, will be incremental. It will result from decisions made by individual Americans, one family at a time. But H.R. 1662 can be a spark that ignites those private decisions to the benefit of our families, our communities, and our heritage as Americans. On behalf of the 265,000 members of the National Trust for Historic Preservation, I strongly urge the prompt enactment of this legislation.

Chairman JOHNSON. Thank you. I appreciate your testimony.
Mr. Kelley, it is a pleasure to have you with us today.

STATEMENT OF RICHARD KELLEY, PRESIDENT, RSK CONTRACTORS, INC., SOUTH WINDSOR, CONNECTICUT, ON BEHALF OF NATIONAL ASSOCIATION OF HOME BUILDERS

Mr. KELLEY. Madam Chairman, my name is Richard Kelley. I have headed a family-run business for the past 25 years in South Windsor, Connecticut. We build all types of housing, ranging from entry-level to moving-up to luxury, in the immediate Hartford suburban area. Our company is involved in every aspect of the development process, from the purchase of raw land to the development of property for both residential and commercial uses.

This afternoon, I have the fortunate opportunity to represent 185,000 members of the National Association of Home Builders. I will paraphrase in the next few minutes a report we submitted to you.

I congratulate you also, Mrs. Johnson, for holding this hearing and giving us the opportunity to present our views from someone who works in the trenches day in and day out. We are also particularly pleased this hearing will address a number of provisions of the Internal Revenue Code which impede land development and, we believe, adversely impact housing affordability.

In this regard, by paraphrasing this morning, we will address several issues: The installment sales rules, the tax treatment of environmental remediation costs, the tax credit for rehabilitation expenditures, and the State tax preference for small businesses.

At the outset, I want to congratulate you for being the catalyst in the Congress, especially introducing H.R. 957, to modify the tax treatment for contributions in aid of construction. The Senate-approved version of H.R. 3448 would repeal the CIAC with respect to water and sewer companies.

Although this proposal was not included in the House-passed version, we ask you, the Representatives of the House, to please recede to the Senate portion of this issue when it is brought to conference.

I also note that the provision was passed by the House as part of the 1995 budget but subsequently vetoed by the President, but it does need to be addressed, and hopefully the House will see fit to look at the Senate version.

First I would like to talk about the installment sales treatment for unimproved residential lots. The current installment sales rules add undue complexity to land development and add significantly to the cost of housing.

Currently, landowners are reluctant to partner with developers because of the installment sales rules. Payment to the original landowner is often contingent upon final sales to the home buyers, which can delay the actual receipt of funds to that landowner for years. However, the installment sales restrictions can require landowners to pay taxes on funds not yet received and discourage them from participating in otherwise efficient transactions.

Further, the complexity of the installment sales rules excludes otherwise qualified land developers from the coverage. This is particularly evident with respect to the installment sales treatment of unimproved residential lots.

Developers like myself selling residential lots to individuals in the ordinary course of business may use the installment method to regain—to report gain from such sales if neither the seller nor the person related to the seller makes any improvements on the lot.

The existing law is unclear as to the definition of the term "unimproved." It is not clear how many common amenities may be constructed before that raw land that can be developed at some time in the future would be considered to have been improved. Additional clarification is needed to define the term "unimproved."

The legislative history of the Tax Reform Act of 1986 says that construction of common infrastructure items such as roads and sewers should not cause raw land to be considered improved.

From the available guidance, land developers find it difficult to determine which common amenities and infrastructure items would cause an individual lot to no longer be considered unimproved.

For example, in a multifamily complex, would the front gate or fencing be considered a common element? Would the construction of a golf course or community clubhouse cause the undeveloped lots to be considered improved within the meaning of the statute?

Without further clarification, these questions would undoubtedly lead to increased controversy and lawsuits. Clarification and relaxation of these rules will lead to more efficient land use as landowners will have greater flexibility in their paying taxes on income in the year in which it is received.

The second item we would like to address is the tax credit for rehabilitation. We certainly know what is happening to our cities across America. The use of the Federal tax incentives to encourage private investment in historic rehabilitation has probably been one of the most effective frontal programs to promote urban and suburban growth.

We would like to again thank you, Mrs. Johnson, along with other of your colleagues, for introducing H.R. 1662, the Historic Homeownership Assistance Act. NAHB believes that this proposal would enhance historic rehabilitation credit and benefit those who wish to restore their historic homes. It would provide much needed home ownership opportunities and stimulate the revival of decaying neighborhoods and communities by expanding the current historical rehabilitation credit to include buildings owned and occupied as a principal residence.

Promoting the use of existing homes will decrease the need for more development at the fringe of our urban areas. It will encourage rehabilitation of historically significant homes through the proposed tax credit which will increase the preservation of the current stock of homes. Rehabilitation will also increase employment in areas where the historic homes are located, which have more convenient work destinations for the disadvantaged workers in that city than the locations in new residential.

Third, I would like to address tax preference for small businesses. The present estate and gift tax laws operate to destroy family-owned businesses by imposing a tax upon the intergenerational transfer of the business at the worst possible time, the death of the principal owner of the business.

Even worse, a tax incentive from year to year because of inflation is not considered. Home building is dominated by small firms like myself which are very often family-owned and -operated. Our figures show within our organization, NAHB, 79 percent of the members are classified as small businesses, small builders, and 91 percent of those are either principal owners or sole owners.

We commend the proponents of H.R. 2190 that would eliminate the estate tax for each ownership interest of a family-owned business worth up to $1.5 million. This much needed legislation would not only facilitate the transfer of building remodeling businesses to the next generation but do away with the need for many small business owned firms to be sold or forced out of business in order to pay estate taxes.

NAHB strongly urges you to enact this legislation. We cannot overemphasize the importance of some form of tax estate planning.

An alternate proposal would be to address our concern in retaining the existing unified tax, if nothing else works, at a gift tax rate schedule, but to increase the uniform tax and gift tax credit, as our numbers show, to a $1.5 million value. The existing rate structure and credit would be applied to assets that are not part of the business interests. We have clarified that further in the testimony that we have given to you earlier.

Thus, we would urge you, in the alternative, if nothing else seems to be flying, to consider legislation which would increase and index for inflation the unified tax. That is so important for our 185,000 members. But we don't need to represent homebuilders when I say that. I could represent the local chamber of commerce, the local hardware store owner, the local pharmacy owner. It not only applies to 185,000 homebuilders, it applies to people all over America.

Once again, Madam Chairman, I appreciate the opportunity and feel very humble to sit before you until doing our presentation. Thank you for listening.

[The prepared statement follows:]

STATEMENT OF THE

NATIONAL ASSOCIATION OF HOME BUILDERS

Madam Chairman and Members of the Subcommittee:

My name is Richard Kelley and I head RSK Contractors, Inc., a family-run business in operation for more than twenty-five years in South Windsor, Connecticut. We build all types of housing ranging from entry level homes to "move-up" and luxury homes in the immediate Hartford suburban area. Our company is involved in every aspect of the development process from the purchase of raw land to the development of property for both residential and commercial uses.

On behalf of the National Association of Home Builders (NAHB) and our 185,000 members, I congratulate you for holding this hearing and appreciate the opportunity to present our views before your Subcommittee. We are particularly pleased that this hearing will address a number of provisions of the Internal Revenue Code which impede land development and lessen housing affordability.

In this regard, my testimony will address several issues -- the installment sales rules. the tax treatment of environmental remediation costs, the tax credit for rehabilitation expenditures, and an estate tax preference for small business. At the outset, Madam Chairman, I would like to commend you for your steadfast support in removing tax policy barriers to housing affordability as evidenced by your introduction of H.R. 957 to modify the tax treatment of contributions in aid of construction (CIAC). The Senate approved version of H.R. 3448, the Small Business Job Protection Act would repeal CIAC with respect to water and sewerage companies. Although this proposal was not included in the House approved version of H.R. 3448, we would ask that the House conferees recede to the Senate position on this issue when it is brought to conference. I note that this provision was passed by the House as a part of the vetoed 1995 Budget Act.

Installment Sales Treatment for Unimproved Residential Lots

Allowing the sale of unimproved land to be taxed incrementally as payments are received rather than entirely when a contract is signed allows land owners, developers and builders to plan land use more efficiently and to reduce the ultimate cost of homes to the customer. Land development has become a time consuming and expensive operation for many of the members of NAHB. Local regulations, anti-growth sentiments, environmental concerns, and difficult and complex financing arrangements have increased the cost of developing land into lots for home building. Many of our members are turning to the original land owner as a partner in financing, and developing, large subdivisions, planned communities and mixed-use developments.

NAHB believes the installment sales rules add undue complexity to land development and add significantly to the cost of housing. This is particularly evident with respect to the installment sale treatment of unimproved residential lots. As you are aware, dealers in real estate are generally prohibited from using the installment method for reporting sales or other dispositions. An exception to this prohibition applies to the installment sales of residential lots. Under I.R.C. section 453(l)(2)(B) dealers selling residential lots to individuals in the ordinary course of business may use the installment method to report gain from such sales if neither the seller nor any person related to the seller makes any improvements on the lot. A residential lot has been defined as a parcel of unimproved land upon which the purchaser intends to construct a dwelling unit for use as a residence by the purchaser.

Additional clarification is needed as to the definition of the term "unimproved". The legislative history of the Tax Reform Act of 1986 provides that, with respect to determining whether land is unimproved "a parcel of land is not to be considered improved or developed if it merely has been provided with the benefits of common infrastructure items such as roads and sewers." Tax Reform Act of 1986, section 811; *See also*., Temp. Treas. Reg. section 1.453C-8T. From the available guidance, land developers find it difficult to determine which common amenities and infrastructure items would cause an individual lot to no longer be considered "unimproved". For example, would the front gate or fencing of a "gated community" be considered a common element? Would the construction of a golf course or community club house in a development cause the undeveloped lots to be considered "improved", within the meaning of the statute? Without legislative clarification, these questions will undoubtedly lead to increased controversy and litigation.

The union of existing land owners with home builders and developers reduces the amount of borrowed funds that must be tied up, sometimes for years, while development proceeds. The reductions in borrowing costs can be passed on to home buyers. However, land owners are often reluctant to partner with developers and home builders because of the installment sale rules. Payment to the original land owner is often contingent upon final sales to the home buyers, which can delay actual receipt of funds for years. However, the installment sales restrictions can require land owners to pay taxes on funds not yet received and discourage them from participating in otherwise efficient transactions.

As a result, landowners are less likely to sell to builders on an installment basis. Landowners also seek higher land sale prices to compensate for the additional tax burden. Higher land costs and fewer willing land owner partners in new home building increases the cost of new homes and creates affordability problems for potential home buyers. Clarification and relaxation of these rules will lead to more efficient land use as land owners have greater flexibility in paying taxes on income to the year in which it is received.

Tax Treatment of Environmental Remediation Costs

The costs incurred in remediation of environmental contamination should be deductible in the same year they are paid and should not be required to be capitalized. We believe that Internal Revenue Service rulings in this area indicate that the proper tax treatment of environmental cleanup costs must be clarified legislatively.

Generally, the cost of incidental repairs that neither materially add to the value of property nor prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as a business expense in the year paid. The Internal Revenue Code requires that costs that materially add to the value, or substantially prolong the useful life, of property owned by the taxpayer, or that adapt property to a new or different use, must be capitalized and written off over a period of time.

Cleanup costs can be considered as expenses necessary to maintain a property in ordinary efficient operating condition. If a property is contaminated sufficiently to require significant cleanup costs, the effective value of the property during the cleanup phase is zero. The costs incurred to remove the contaminants are necessary to bring the property into an ordinary efficient operating condition. The cleanup costs do not materially increase the value of the property, but bring the property into a condition in which it can be marketed.

The current tax law does not provide for the deductibility of cleaning up property that is already contaminated when purchased. Property owners who were unaware of contamination or who are subject to new regulations or restrictions after purchase, may not be able to deduct clean-up costs in the year the costs are paid and may very well be required by the IRS to capitalize such costs and recoup them through amortization. Requiring cost amortization discourages holding property for sufficient time to plan and develop the property to its full potential. Also, requiring amortized costs encourages land owners to sell quickly in order to record the cost against income which further delays careful planning and orderly developments. NAHB believes that the tax law should stimulate and encourage abatement of health hazards in the Nation's housing stock.

We urge you to amend the Internal Revenue Code to allow environmental cleanup costs, such as for contaminated soil and groundwater, to be deductible in the year in which they are incurred and allow a current year deduction of costs for clean up of property that is already contaminated when purchased.

Tax Credit for Rehabilitation Expenditures

We would like to thank you, once again, Madam Chairman along with Representatives Clay Shaw (R-FL), Barbara Kennelly (D-CT), Jim McCrery (R-LA), Richard Neal (D-MA), and Richard Zimmer (R-NJ) for introducing H.R. 1662, the Historic Homeownership Assistance Act, which would provide for a 20 percent tax credit, up to a maximum of $50,000 or, if the taxpayer should choose, a transferable mortgage credit certificate, for the rehabilitation of certified historic structures used as a principal residence by the owner. We commend you for your unwavering support for affordable housing and eliminating tax impediments to its creation.

NAHB believes that this proposal would enhance the historic rehabilitation credit and benefit those who wish to restore their historic homes. It would provide much needed homeownership opportunities and stimulate the revival of decaying neighborhoods and communities by expanding the current historic rehabilitation credit to include buildings owned and occupied as a principal residence. Not including an income cap with respect to principal residences would foster economic diversity within the buildings. By providing for a transferable mortgage credit certificate the bill would allow lower income taxpayers to use the credit to facilitate payment of acquisition costs. H.R. 1662 is a needed step in the right direction.

Promoting the re-use of existing homes will decrease the need for more development at the fringe of our urban areas. Encouraging rehabilitation of historically significant homes through the proposed tax credit will increase the preservation of the current stock of homes. Rehabilitation will also increase employment in the places where the historic homes are located, which are often easier work destinations for disadvantaged workers than the locations of new residential construction.

Estate tax preference for Small Business

The current estate and gift tax laws operate to destroy family-owned businesses by imposing a tax upon the inter-generational transfer of the business. Moreover, the economic impact of the tax increases from year to year because of inflation. Home building is dominated by small firms which very often are family owned and operated (79% percent of NAHB membership are classified as small builders and 91% are either principal owners or sole owners. *NAHB Housing Economics*, July 1995 p. 12). NAHB fully supports estate tax reform for small businesses.

The federal estate tax is imposed on the value of property passing at death. The estate tax rates begin at 18 percent on the first $10,000 in taxable transfers at death and reach 55 percent on taxable transfers over $3 million. The amount of estate and gift tax is calculated by multiplying the tax rate by the taxable transfers at death and subtracting the estate and gift tax credit which is currently $192,800. This effectively exempts estates less than $600,000 from taxation.

We commend Representatives Jim McCrery (R-LA), Jennifer Dunn (R-WA), Wally Herger (R-CA), L.F. Payne (D-VA), Mel Hancock (R-MO), Jon Christensen (R-NE), Greg Laughlin (R-TX), Jim Hayes (R-LA), John Ensign (R-NV), Jim Nussle (R-IA), Rob Portman (R-OH) and Mac Collins (R-GA) for having introduced legislation (H.R. 2190) which would eliminate the estate tax for each ownership interest of a family-owned business worth up to $1.5 million. For business ownership interests over $1.5 million, only one-half of the excess (the monies over $1.5 million) would be taxed. That is, for an estate worth $2.0 million, the first $1.5 million given at death would be tax-free and only $250,000 would be taxed.

An alternative to H.R. 2190 would be to retain the existing unified estate and gift tax rate schedule, but to increase the unified estate and gift tax exemption amount to $655,800 for each ownership interest of a family-owned business. This would effectively eliminate estate taxes on family-owned businesses valued at less than $1,500,000. The existing rate structure and credit would be applied to assets that are not part of the business interest (as shown in the following diagram).

Exhibit
Difference in Estate Tax Liabilities for
Different Levels of Taxable Estates:
Current Law vs. NAHB Proposal

	Estate Tax Estimates	
Taxable Estate	Current Law	NAHB Proposal
$600,000	$0	$0
700,000	37,000	0
800,000	75,000	0
900,000	114,000	0
1,000,000	153,000	0
1,500,000	363,000	0
2,000,000	588,000	125,00[illegible]
2,500,000	833,000	370,00[illegible]
3,000,000	1,098,000	635,00[illegible]
Over 3 million	$1,290,800 + 55% of excess over $3,000,000	$635,000 + 55% of excess over $3,000,00[illegible]
NAHB ECONOMICS		12 July 1996

As mentioned above, the majority of NAHB's members are small businesses, many of which are family owned. H.R. 2190 would eliminate, or significantly lower, the estate tax on most family-owned building/remodeling firms. This much needed legislation would not only facilitate the transfer of building/remodeling businesses to the next generation, but would do away with the need for many small family-owned building and remodeling firms to be sold or forced out of business in order to pay estate taxes. H.R. 2190 would provide much needed, and long awaited, relief from the estate tax for our members. NAHB strongly urges you to enact this legislation.

In the alternative, significant estate tax reform is urgently needed and we would urge you to enact legislation which would increase, and index for inflation, the unified credit.

CONCLUSION

NAHB urges you to pass these legislative proposals as soon as possible. Enactment of these proposals would simplify the tax laws, establish good tax policy and benefit out national economy. I would be pleased to answer any questions you might have.

Chairman JOHNSON. Thank you for your excellent testimony with a variety of suggestions. It is an issue that we are very concerned with, not only in the agricultüre community but in the small business community.

Mr. MacEwen.

STATEMENT OF BRUCE W. MAC EWEN, VICE PRESIDENT, TAXATION, PORTMAN HOLDINGS, L.P., ATLANTA, GEORGIA, ON BEHALF OF NATIONAL REALTY COMMITTEE

Mr. MACEWEN. Chairman Johnson and Members of the Subcommittee, good afternoon.

My name is Bruce MacEwen. I am vice president of taxation of Portman Holdings, a national firm headquartered in Atlanta, which owns, manages, and develops office, retail, and hotel properties throughout the United States as well as in several foreign countries.

I am here today on behalf of the National Realty Committee, where I serve as vice chair of its tax policy advisory committee. My testimony will focus on how the current tax law discourages businesses from investing in and redeveloping land located in the urban centers of our country.

A number of these provisions are detailed in our written statement, but I would like to highlight three key areas of tax policy: Cleaning up contaminated land, demolishing and redeveloping abandoned structures, and modernizing and reconfiguring existing commercial space.

First, the cleanup of contaminated land and structures adds to the cost of the redevelopment project, often significantly. Depending on the extent and type of contamination, these costs often reach into the tens of thousands of dollars, and sometimes millions. In most areas of the country, but particularly in central city areas, adequate financing to carry out both cleanup and development activities is not available at affordable costs. Owners and lenders are concerned not only about the costs and risks but also about liability.

Additionally, cleanup requires time and delay, further increasing up-front costs which affect the ultimate profitability of a project. Therefore, the tax laws relating to cleanup expenses are of vital importance to the project.

At present, the tax laws in this area offer no incentive to invest in and clean up contaminated land versus clean, previously undeveloped land. Instead, these cleanup costs must be added into the basis of the land itself, meaning that they are not recoverable through depreciation.

A provision to spur the cleanup of so-called "brownfields" by allowing purchasers to immediately deduct the cost of cleaning up contaminated land in Federal empowerment zones and enterprise communities has recently been proposed by Congressman Rangel. We applaud him and others for recognizing part of this larger problem.

However, we would urge that the concept of providing a tax incentive for the cost of cleaning up acquired contaminated land not be confined solely to targeted empowerment zones. If immediate deductibility is provided for targeted areas, then, at a minimum, some rapid writeoff period should be established for nontargeted areas, perhaps 5 years.

The second area I want to highlight concerns the demolition and redevelopment of abandoned nonhistoric structures, a situation more likely to occur in urban rather than suburban areas. Since 1984, all demolition costs for nonhistoric buildings must be added to the basis of land rather than deducted. This discourages the acquisition of land on which there is a building which must be demolished in order to use the land more productively. We propose a return to pre-1984 treatment of demolition costs.

Finally, the long cost recovery period associated with the modernization and reconfiguring of existing commercial space in urban areas discourages the revitalization of buildings and the reuse of land in America's cities. Instead of the building owner recovering the expenses incurred to construct so-called leasehold improvements over the life of the improvement, today's rules dictate that such expenses must be recovered over the life of the overall building which is now depreciated over 39 years. Seldom do tenants sign leases of 39 years or more.

Compounding this, significant ambiguity surrounds how a real estate owner accounts for leasehold improvements that are demolished before the end of the recovery period in order to make way for a new tenant. To address this so-called closeout problem, we are supporting a provision first introduced by Congressman Shaw and other distinguished Members of your Committee and included in the Senate version of the Small Business Jobs Protection Act. We strongly urge House support of this provision in conference with the Senate.

Let me state in closing, we believe that a more reasonable policy must be established for the costs of cleaning up contaminated land, perhaps a more generous incentive in targeted areas, but an incentive in nontargeted areas as well. We believe the tax treatment of demolition expenses should be revised.

Finally, we urge the House to accept the leasehold improvements provision contained in the Senate version of the Small Business Jobs Protection Act. These actions would, without a doubt, help generate jobs and maintain commercial real estate asset values and, as a result, help restore and stabilize the health of our urban centers.

Thank you very much.

[The prepared statement follows:]

STATEMENT OF THE NATIONAL REALTY COMMITTEE

TO THE SUBCOMMITTEE ON OVERSIGHT

OF THE COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

REGARDING

TAX LAW AND LAND USE

Bruce W. MacEwen
Vice Chairman
Tax Policy Advisory Committee
National Realty Committee

July 16, 1996

Introduction

Congresswoman Johnson, members of the Subcommittee on Oversight of the Committee on Ways and Means, good afternoon. My name is Bruce W. MacEwen, and I am Vice Chair of the Tax Policy Advisory Committee of National Realty Committee (NRC).

NRC serves as Real Estate's Roundtable in Washington on national policy issues affecting real estate. NRC's members are America's principal commercial and multifamily real estate owners, advisors, builders, investors, lenders and managers. Portman Holdings, L.P., where I serve as vice president of taxation, owns, manages and develops office, retail, residential and hotel properties throughout the United States as well as in several foreign countries. It is because of NRC's significant concern with policies that affect our nation's communities and cities, and because of Portman's vast experience in committing substantial investment in America's cities (primarily downtown centers), that I am here today to present testimony regarding the impact of the federal tax law on land use.

As noted in your release announcing these hearings, there presently exists a number of tax provisions which may have unintended consequences for land use. In particular, I'd like to offer NRC's views and recommendations on that aspect of your Committee announcement that concerns those provisions of current tax law that may act to discourage businesses from investing in urban areas — not only in vacant urban land, but in developing or redeveloping any structure on such land necessary for job and economic growth to occur.

Clearly, business investment decisions concerning urban areas are not driven by federal tax policy alone. A more complete picture also would require inquiry into a number of other major sets of circumstances including efforts to control crime as well as the interplay of local governance, transportation issues, and the role of independent public authorities in regional development. Nonetheless, federal tax policy can play a significant role in affecting business investment in our nation's cities. We therefore welcome the opportunity to explore this interplay with the Subcommittee; and, we look forward to working with you, Congresswoman Johnson, and members of the Subcommittee, as you continue your work in this area.

Summary

National Realty Committee believes that federal tax policies should serve as neither an incentive to unjustifiable, excessive real estate investment, nor as a disincentive to prudent, needed investment which would benefit our nation's communities, including urban areas. Indeed, as we all witnessed during the drastic decline in real estate values in the early 1990s, America's cities, taxpayers, and savers all have a stake in rational, growth-oriented real estate tax policy and sound real estate asset values. Today, commercial and multifamily real estate asset values generally continue to rebound slowly from the substantial real estate asset devaluation that occurred earlier this decade. Notwithstanding these national market conditions, in many local markets the real estate recovery is still fragile, if not precarious, leaving many cities and counties with less than optimum land use as well as reduced property tax revenues and public services.

As explained in greater detail in this statement, a number of provisions in the current tax law act to reduce the relative appeal of urban land as a development investment alternative and tend to hold previously used urban land below its optimum use. Chief among these provisions are those that:

- discourage the acquisition and development of vacant land in urban areas through the lack of any recovery of costs associated with cleaning-up environmentally contaminated land;
- discourage the redevelopment of existing structures in urban areas due to the high cost of removing and replacing potentially hazardous materials such as asbestos and the apparent governmental view that in most cases such costs should be capitalized as a long-term improvement rather than deducted as a repair;
- discourage the modernization and reconfiguration of existing commercial space in urban areas due to the excessively long cost recovery rules associated with constructing improvements to the structure to accommodate the needs of office and retail tenants;
- require many development costs to be considered acquisition costs therefore requiring such costs to be capitalized into the basis of the land rather than added to the depreciable basis of the developed building; and,
- discourage demolition and redevelopment of abandoned structures by requiring that demolition costs, as well as the cost of the demolished structure itself, be added to the nondepreciable basis of land rather than added to the basis of any replacement structure and recovered through depreciation.

It is also worth noting that the existing tax incentives designed to entice businesses to locate in empowerment zones (an employment and training credit, an additional expensing allowance, and the recent addition of a new category of tax-exempt private activity bonds) do not provide any additional incentive to invest in the nondepreciable land (contaminated or not) or the depreciable structure necessary to house and operate the business intended to locate in the empowerment zone. This deficiency may substantially influence certain investment decisions in empowerment zones.

Discussion

Environmental Remediation Expenses

In National Realty Committee's view, one of the more significant aspects of the current tax law which discourages businesses from investing in urban areas concerns the tax treatment of environmental remediation expenses. There are two specific examples which immediately come to mind. These concern the lack of clear guidance regarding the recovery of costs associated with cleaning-up environmentally contaminated urban land (including the so-called urban "brownfields"), as well as uncertainty concerning the tax treatment of the costs related to removing hazardous materials from existing buildings.

While this issue can also affect suburban properties, typically remediation issues are more costly in urban land settings.

Since the enactment of the Comprehensive Environmental Response, Compensation and Liability Act (1986), the Resource Conservation and Recovery Act (1976) and the Toxic Substances Control Act (1976), real estate owners have become responsible for remediating a variety of different types of hazardous materials. During the same time period, market conditions also increasingly required the clean-up of real and perceived environmental hazards. Although the tax treatment of the clean-up of such environmentally hazardous situations was generally thought to be deductible, beginning in 1992, through a series of Technical Advice Memoranda (resting largely on the question of whether the clean-up expense increased the value of the asset), the Internal Revenue Service has interpreted case law in a manner that has seemed to require a vast number of such expenses to be capitalized as an improvement, rather than deducted as a repair.

The present state of the law regarding land clean-up expenses is murky at best. It now seems that an owner of land that was not contaminated at the time of acquisition may deduct certain — but not all — of the costs incurred to remediate contamination occurring during the period of ownership. However, IRS officials have stated that costs to remediate land purchased in a contaminated state, including land purchased with underground storage tanks, must be capitalized and added to the basis of the non-depreciable land. This aspect of the current tax law cries out for clarification of the proper tests that will ensure that costs incurred to clean-up contaminated land are deductible.

Partially addressing this issue, the Administration included in its most recent budget proposals a proposal to spur the cleanup of so-called "brownfields" by allowing new purchasers and other businesses a targeted tax incentive to recover certain costs to remediate environmentally contaminated brownfields properties. (The term brownfields generally refers to certain abandoned, contaminated industrial or commercial properties that are less toxic than Superfund sites, but still face barriers to their redevelopment.) The tax incentive (immediate expensing) is proposed to apply to the cleanup of brownfields in high-poverty areas, existing Environmental Protection Agency brownfields pilot areas, and federal empowerment zones and enterprise communities. Legislation (H.R. 3747) embodying this concept was recently introduced by Representative Rangel. While supportive of this approach (which should be extended to non-targeted areas as well), we also believe that any efforts in this area also must include non-tax related provisions that provide certainty to real estate owners and lenders regarding potential liability for the costs of cleaning up hazardous materials on their property. Protection from liability also should be provided to owners where contamination occurs by the disposal of hazardous materials by owners or users of contiguous property. Greater investment in our nation's urban land is much more likely to occur when investors and lenders can be confident that they will not expose themselves to unwarranted liability, and where the tax laws applicable to environmental remediation do not act as a deterrent or disincentive to needed clean-up operations.

We would urge that the "brownfields" concept providing an immediate tax deduction for the costs of cleaning up acquired contaminated land in targeted areas be extended to non-targeted areas as well. If not immediate deductibility, than some rapid amortization period would seem appropriate for non-targeted areas.

On the issue of the deductibility of costs associated with remediation of potentially hazardous materials in existing structures (such as asbestos), great uncertainty regarding whether such costs are capitalized or deducted also has developed. Because many buildings located in urban areas may contain potentially hazardous materials such as asbestos, and therefore due to market perceptions may need to be remediated, this issue could significantly deter investment decisions in urban areas. We would urge that the Internal Revenue Service provide guidance in this area to simply restate the law regarding repair expenses as it clearly existed prior to the IRS releasing the related TAMs beginning in 1992 — that is, that the repair doctrine presented in the Tax Court's decision in *Plainfield-Union Water Company* is correct law. This case held that for purposes of determining whether an expenditure increases the value of property and, therefore, must be capitalized, the proper comparison is between the value of the property after the expenditure and the value of that property before the condition requiring the expenditure. This would help to ensure that the costs associated with remediating asbestos in long-held properties would be deductible repairs.

Most important in this area of environmental cleanup costs is that the current law: 1) provides no clear incentive to clean-up; and, 2) requires compliance with burdensome regulations. These factors have a significantly negative effect on investment in land, especially in urban areas.

Land Development Expenses

Some have noted that the current cost recovery provisions discourage businesses from investing in urban areas because, while plant or equipment can be depreciated, the land on which a structure is built cannot. This is said to encourage non-urban investment where land costs are lower, therefore allowing a greater portion of the investment to be recovered through a depreciation allowance. This factual point is amplified when one considers that: 1) land costs are currently not recoverable for tax purposes, therefore significantly reducing its appeal as an investment; and, 2) the amount of investment in land development which must be capitalized has increased dramatically over the past 20 years, making a greater portion than ever of development costs either not recoverable at all, or recoverable over a substantially longer period than its economic useful life.

Clearly, tax treatment that capitalizes a greater and greater portion of land development costs tends to discourage investment in higher cost urban areas. Here are a few examples of this troubling trend:

- IRC Section 280B, added to the Code in 1976 and expanded in 1984, requires that demolition costs, as well as the cost of the demolished structure itself, must be added to the basis of land rather that deducted. This tends to discourage the acquisition of land, including a structure which must be demolished in order to construct a more suitable physical plant, because the costs of demolition are not recovered until the underlying land is disposed. A more appropriate tax result would permit depreciation of demolition costs.

- IRC Section 189, which permitted a 10 year amortization of construction period interest and taxes, was repealed in 1986. The result is that such expenses now must be added to the basis of the building being constructed and depreciated over a straight-line basis, generally 39 years for nonresidential property. Thus, the capital recovery period for construction period interest and taxes has jumped from 10 years to 39 years since 1986.

- Section 263A, relating to the capitalization of construction period expenses (e.g., interest, taxes, insurance), was added to the Code in 1986 and final regulations were promulgated in 1994. In general the effect of these rules is to greatly increase the amount of interest and taxes which are required to be capitalized (and recovered on a straight line basis, generally 39 years). For example, commencement of construction of common improvements such as feeder roads are deemed to start the capitalization "clock" as to all phases of construction benefited by such improvements — even if construction of a given phase of development is years off. This provision also adopts the "avoid cost" method of capitalizing interest which requires a taxpayer to reallocate interest expense to construction from loans used for unrelated purposes — even when it can clearly be demonstrated that a given land purchase or construction activity was funded with equity not debt. In effect, the rule requires a taxpayer to impute interest expense to construction expenditures funded by his own equity if his balance sheet has any debt — whether or not such debt is related to the development.

- Beginning in 1981, and revised in 1984 and 1986, land improvement costs such as those incurred for landscaping and surface parking lots were required to be recovered over an arbitrary period much longer than their economic useful life — currently the statutory period is 15 years. In a commercial context, such improvements as roads and surface parking have much shorter useful lives — generally between 5 and 7 years.

We would urge a comprehensive review of the tax laws concerning the capitalization of land development expenses, including demolition expenses (which at a minimum should be added to the basis of the replacement structure and not to the nondepreciable land).

Leasehold Improvements

Today's tax policy governing the recovery of costs associated with constructing leasehold improvements (internal walls, ceilings, partitions, plumbing, lighting and finish) misstates economic reality, and as such inhibits employment opportunities, discourages environmentally efficient building improvements and discourages the revitalization of America's cities. Instead of a building owner recovering the expenses incurred to construct leasehold improvements over the life of the *constructed leasehold improvement*, today's rules dictate that such expenses be recovered over the life of the *overall building*, which is now depreciated over 39 years.

Compounding one problem (regarding the unrealistic time period over which leasehold improvement costs are required to be recovered) is another problem — significant ambiguity surrounding how a real estate owner accounts for leasehold improvements that are demolished before the end of the prescribed recovery period, in order to make way for a new tenant. Prior to 1981 it was clear that an owner could deduct the remaining unrecovered cost in the year in which the improvement was demolished. Beginning in 1981, and certainly since 1986, whether the owner has retained this ability is unclear in many circumstances.

What's the fallout of today's flawed policy in this area? To begin with, the after-tax cost of reconfiguring, or "building-out", space to accommodate a new tenant is artificially high. Because the owner is unable to fully deduct the economic costs expended on leasehold improvements over the improvements' useful life, the owner's income is artificially inflated for tax purposes. To make matters worse, the current policy hinders urban renewal and construction job opportunities as improvements are delayed or not undertaken at all. Like factories in need of retooling so they can produce the most advanced kinds of products, many buildings today need to be retooled to provide the environment necessary to house and grow businesses of the future.

Historically speaking, the concept of economic cost recovery is fundamental to the integrity of America's tax system. True net income is determined by recovering the costs expended on an investment over the same period of time as the investment earns income. This "matching" precept has long been embedded in the tax code. Prior to the Economic Recovery Tax Act of 1981 ("1981 Act"), a building owner was generally entitled to recover the costs associated with constructing leasehold improvements over their useful lives, such as the term of the lease for which they were constructed. Appropriately, this policy reflected the fact that improvements constructed for one tenant are rarely suitable for another, and that when a tenant leaves, the space is typically built-out all over again (or at least substantially renovated) for a new tenant. With the 1981 Act, however, the concept of matching income from the lease with the costs of leasehold improvements was set aside as the system of component depreciation for real estate was abandoned.

In an effort to simplify depreciation laws, a single depreciation life of 15 years was established for buildings and leasehold improvements made to them by owners.

Since the 1981 Act, however, the recovery period for nonresidential real property has been lengthened to 39 years. With these depreciation changes, however, has come no distinction between the capital cost recovery of buildings themselves and the periodic internal improvements made to accommodate specific tenants.

Thus, in the relatively short time between 1981 and 1986, the tax treatment of leasehold improvements dramatically changed from a flexible depreciation system that sought to accurately match income with expenses to a system that dictates a recovery of expenses over a period that in no way reflects the useful life of these improvements. In light of this situation, now is an opportune time to revisit and modify these rules, which over time have been increasingly problematic.

To address this important tax problem NRC is pleased to endorse a provision approved last year as part of the balanced budget tax legislation which would have clarified that building owners may fully deduct and close out any unrecovered leasehold improvement expense remaining at the time the tenant improvement is destroyed. This provision is now included in the Senate version of the Small Business Jobs Protection Act and we strongly urge House support for the provision in Conference with the Senate. Additionally, House legislation (H.R. 1171) has been introduced by Ways and Means Committee members E. Clay Shaw, Jr. (R-FL) and Charles B. Rangel (D-NY) to reduce the recovery period for certain tenant improvements from 39 to 10 years. This legislation would be a significant step in the right direction of more accurately matching income with expenses.

Empowerment Zones

In 1993, a series of special federal income tax provisions was enacted to expand business and employment opportunities in a limited number of qualifying economically distressed urban and rural areas throughout the country (empowerment zones). Among these special tax incentives were provisions to provide an employment and training tax credit, an additional $20,000 per year in section 179 expensing, and a new category of tax-exempt private activity bonds. At the time these rules were enacted, and still today, we believe that in order to significantly increase the economic activity and job growth in these targeted areas requires an investment incentive for expenditures incurred in connection with the acquisition, rehabilitation or reconstruction of any nonresidential building located in these qualifying empowerment zones. While recent Administration proposals and Representative Rangel's legislation (H.R. 3747) propose to provide tax assistance to clean-up certain hazardous waste in empowerment zones, consideration should be given to encourage investment in non-contaminated land as well.

Conclusion

National Realty Committee appreciates the opportunity to comment on the current tax provisions which we believe needlessly discourage investment in urban land and cities. We believe that the provisions relating to the tax treatment of environmental remediation are in serious need of clarification so that investment is not discouraged due to the inability to recover clean-up costs. At the same time, the tax treatment of demolition expenses should be reviewed, and attention should be paid to the compounding effect of rules requiring more and more land development costs to be capitalized. Most important, in today's debate, we urge members of the House to accept the Senate provision on leasehold improvements which is contained in the Senate version of the Small Business Jobs Protection bill, and consider adopting a shorter time period in general for leasehold improvements along the lines of the Shaw-Rangel bill. These actions would, without a doubt, help generate jobs and maintain commercial real estate asset-values and, as a result, help urban areas grow.

Thank you.

Chairman JOHNSON. I thank the panel for your excellent testimony.

We are very concerned with the tax impact of some of these things, the cleanup costs. I was not aware of the demolition issue on urban areas and on land use in urban areas. There are many appropriate areas in our cities that should be used again for commercial purposes rather than commerce moving out to some of the more rural areas, and part of protecting our rural areas is enabling land in inner cities to be used for its historic commercial purposes. I appreciate your testimony on these issues.

There is broad bipartisan interest in enterprise zones, as now both the administration and Mr. Rangel have proposed and a number of Republicans have proposed and are supporting the Talent-Watts bill. I would like your thoughts on the impact of selective benefits for specific areas as opposed to tax changes that are more comprehensive. In other words, do you have any thoughts on those enterprise zones?

Mr. MACEWEN. I think my position would be that we certainly favor the enterprise zone concept. The benefits, I think, are well directed. I also think that the enterprise zone concept can be expanded into a broader perspective to address some of the issues that my comments addressed.

Chairman JOHNSON. Thank you.

Anyone else? Any comment on enterprise zones?

Mr. KELLEY. I think the history of the enterprise zone is a good format, Congresswoman. It could be expanded into other areas, using that as a base for experience. It does work around the country, no question about it.

Chairman JOHNSON. Ms. Osterman, your testimony mentions that the passive loss and income restrictions imposed in the 1986 tax reform act have limited the impact of the rehabilitation credit. Could you enlarge on that?

Ms. OSTERMAN. The 1986 act severely restricts the ability of investors to utilize real estate losses to offset taxes on ordinary income. That has been the principal effect on the desirability of utilizing the existing rehabilitation tax credit.

Other changes in the tax act that are important are the reduction of the credit from 25 to 20 percent and also income restrictions that basically make it very difficult for individuals with incomes above $250,000 to utilize the credit as investors.

I would like to point out to the Chairman, to the Subcommittee, that the passive loss limitations and income caps and other provisions that currently prevail over the existing rehabilitation tax credit would not apply under the proposed historic home ownership tax credit, because that would not be an investor tax credit but would be used for a principal residence. This would not be subject to any of those kinds of limitations.

Chairman JOHNSON. I understand. Thank you.

Mr. Kelley, in your presentation you talked extensively about installment sales treatment of unimproved residential lots. You make the point very effectively that rules can be very costly and complicated. What impact do these rules have on decisions about where to build?

Mr. KELLEY. Mrs. Johnson, it has a tremendous impact. Personally, we are dealing with a property owner now which happens to be in a farming area of about 65 acres. When we approached the farmer—he is well into his eighties now—about working with us as a partner, of taking his farmland and letting us only take one piece of it and turn it into housing, and using the vast majority of it to turn into a community park, for him to take a tax credit, when his accountant and attorney got through with it, that idea was immediately thrown out, because their concern was, the only way that this person could do that, the landowner, would be to create a charitable trust, put that land, the profit, into the charitable trust.

But their problem was, when is the charitable trust going to be funded? I said to them it is impossible to fund it up front, so you have got to fund it over a course of 2 or 3 years when we build the houses. Their concern, the accountant's concern was, he is going to have to pay taxes on money that he doesn't have.

My idea is, if Congress could take a look at what we are talking about, let us have some input, since a lot of us are in the trenches and are doing this all the time, that land use and land development in the years to come will look much different than it has in the past.

We, because of haste—and I am as guilty as others—because of haste, because of some of the restrictions we have, the land use probably would have been better off if we had slowed down, if we could have, and taken the time and done something a little different.

The tax credit means installment sales, just like environmental. A portion of this person's property, we are concerned, it has contaminants on it. If there is, does the law permit him or would the law even permit me to clean up that portion of that 67 acres that has the contaminants on it and take it off the cost of that land? Or would he or I have to put it over a schedule for 20 or 30 years? It depends on what we put on to that piece of contaminated land.

That is why we are sitting before you this morning, saying to Congress, saying to Representative Hancock and Mrs. Johnson sitting here listening to us, that things have got to change, that we all have to be a part of it in order for those things to change in the future.

Chairman JOHNSON. That is a very interesting point you make about taking the cleanup costs off of the land.

Mr. KELLEY. Did I answer your question?

Chairman JOHNSON. Yes, thank you.

Mr. Hancock—whose plane just got in a few minutes ago—I am glad to have you.

Mr. HANCOCK. This is a subject that I have been very interested in for some 25 years or more.

There is a theory out there that some people say is even more important than the way the Federal tax applies to the development of real estate, called land value taxation. Are you familiar with that term?

Mr. KELLEY. No, I am not, sir.

Mr. HANCOCK. As you know, one of the things, the theory is anyway, that has caused urban blight was the skipping over of big areas and going out and buying rural land and holding it until the city or development comes to it. The theory is to calculate the real estate tax, which has a big bearing on these decisions, on the value of the location rather than the value of the improvements—evidently you are not familiar with it at all.

The theory was developed back in the twenties. It happened to be by an economist by the name of George at the University of Missouri. You might want to look it up, take a look at it. It is called land value taxation.

The theory is that we would have never suffered the urban blight if, in fact, property was taxed on the true value of the land. In other words, the tax structure would provide an incentive to improve urban land so that it would be used for its highest or best use. You could not buy a piece of property and let it run down because you are going to get taxed as if you had developed the property.

So I would suggest you take a look at it and maybe incorporate it in part of your work toward providing reasonableness in the Federal Tax Code pertaining to real estate and development.

Mr. KELLEY. I will. Thank you.

Mr. HANCOCK. Thank you, Madam Chairman.

Chairman JOHNSON. Mr. MacEwen, you suggested really a number of different changes that are, each one, important. But if you had to help us target our actions, because we never can do all the things we believe are most important, what areas do you think are most important for us to attend to?

I guess I would open this up to all of you.

Mr. MACEWEN. Changes in the tax law regarding leasehold improvements are very close to fruition and have bipartisan support in both Houses of Congress. Again, the provision will be an issue in the Conference Committee.

With respect to the Business Jobs Protection Act, this is an issue that I think is very important to the development of commercial real estate and establishing reasonable tax policy thereon.

For years, with the frequent changes in the depreciation period, we have seen the depreciation of leasehold improvements go from over the life of the lease, which may be as short as 5 years, all the way up to 39 years now, from 1981 through current law. We have seen a lot of changes.

Thirty-nine years is too long to depreciate a leasehold improvement, where, in the real market today, our leases are 5 years—usually from 5 to 10 years, after which time we have to tear out those improvements and replace them. We are not allowed necessarily to write off those costs today. We have to keep those on the books for 39 years.

This provision, which will come up in conference, will clarify this and would permit a current deduction. So that one is very close to fruition.

The other issues, regarding cleanup and demolition costs, are issues that have been in the forefront now for the last few years with the advent of the asbestos problem. The Service has taken different viewpoints with respect to the deductibility of those costs.

We think there is case law that supports treatment of remediation expenses as repairs because it does not enhance the value of the property, it only restores the property to its previous value.

This doesn't necessarily suggest a legislative fix, but we think the Congress should consider this and look into it.

As far as demolition costs are concerned, these were changed in 1984. Prior to that, you could deduct the cost of a building you demolished. We think a return to pre-1984 tax policy is appropriate and would be particularly helpful in revitalizing America's urban centers, which, as we know, as they deteriorate, tend to be a catalyst for crime, it exacerbates the homeless problem, and we all believe that the revitalization and the maintenance of vital urban centers benefits our communities as a whole.

Chairman JOHNSON. Thank you very much.

Mr. KELLEY. We homebuilders could offer a lot of assistance in this areas because that is one of our issues. The contribution in aid of construction, in the old heydays, when you could go out to a bank and borrow money for any rehabilitation you wanted to do, wasn't so bad over a number of years. But when you are coming up with your own money, aiding someone else's expenditures, it makes a big difference. We could offer a lot of assistance. We have done a lot of work on this aspect. We could participate in that with you if you wish.

Chairman JOHNSON. Thank you.

Mr. MACEWEN. I would like to thank the Members of your Subcommittee as well as the entire Ways and Means Committee for the support of the leasehold provisions, in particular Congressman Shaw who introduced the bill and had several cosponsors.

Chairman JOHNSON. In preparing for this hearing, I think it is fair to say all the Members who testified, and the Members of the Subcommittee, have been impressed with how many provisions there are in the Tax Code, what a scatter shot pattern they have in terms of a public policy, how important it is to really understand far better the implications of the current impact of tax law on land use decisions and land preservation decisions as well as proper development decisions.

It is interesting that you could even work with the farmer to develop land in a way that would be respectful of our conservation needs as well as his economic needs, because of a variety of problems in the tax law.

So we do hope to straighten out some of the problems in the tax law and support some of the initiatives that the Members have offered. And then there are a number of other areas that you suggested and brought to our attention that we appreciate.

Our goal overall, not all to be accomplished this term certainly, is to provide a better comprehensive structure within which to look at land use proposals, but also to develop a more integrated land use policy for the Nation.

Thank you very much for your participation, I appreciate your preparation, and for your help at this point in the process, and I know for your continuing help as we move through this. Thank you very much.

[Whereupon, at 1:30 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

DEPARTMENT OF THE TREASURY

TREASURY NEWS

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FOR IMMEDIATE RELEASE
July 16, 1996

STATEMENT BY TREASURY SECRETARY ROBERT RUBIN
ON THE PRESIDENT'S BROWNFIELDS TAX INCENTIVE
AND EMPOWERMENT ZONE PROPOSALS

Today, the Ways and Means Oversight Subcommittee will be considering tax incentives to encourage cleanup and redevelopment of contaminated and economically distressed sites. Earlier this year, President Clinton called for such an incentive in his State of the Union address and included this initiative, fully paid for, in his FY 1997 budget.

The President's brownfields tax incentive will spur the cleanup and redevelopment of thousands of contaminated sites, and together with the new Empowerment Zone and Enterprise Community proposal, will help to rebuild neighborhoods, create jobs, and restore hope to our nation's cities and distressed rural areas.

I thank Congressman Rangel for introducing H.R. 3747, containing the President's brownfields tax incentive and Empowerment Zone proposals, and Senators Moseley-Braun, Jeffords and D'Amato for introducing a companion measure, S. 1911, in the Senate. The Administration strongly urges the Oversight Subcommittee to favorably consider these proposals.

RR-1173

Background

Under the President's brownfields tax incentive, environmental cleanup costs would be fully deductible in the year in which they are incurred -- a significant incentive that would reduce the cost of capital for these types of investment by more than half. The $2 billion incentive is expected to leverage $10 billion in private investment, returning an estimated 30,000 brownfields to productive use. The incentive would be available in 40 of the existing EPA Brownfields pilot areas, in areas with a poverty rate of 20 percent or more, in adjacent industrial or commercial areas, and in Empowerment Zones and Enterprise Communities, both existing ones and those that would be designated in the second round.

The Clinton Administration's Empowerment Zone and Enterprise Community program was authorized by Congress in the Omnibus Budget Reconciliation Bill of 1993. This program was designed as a competitive demonstration program for revitalizing distressed communities pursuant to a strategic plan developed at the community level and supported by local and state governments, the federal government, and the private sector. Over 500 communities that satisfied various poverty, population, and size criteria were nominated for designation, with many communities hailing the application process itself for producing tremendous benefits. On December 21, 1994, nine Empowerment Zones and 95 Enterprise Communities were designated. Qualifying businesses in all of the designated areas became eligible for a new category of tax-exempt financing, and businesses in Empowerment Zones also became eligible for a significant federal wage credit and a capital investment incentive.

The Empowerment Zone and Enterprise Community proposal, which is an important component of the President's Community Empowerment agenda, would authorize a second round of designations, adding another 100 distressed urban and rural communities to the 104 designated in December 1994. The second round would build upon the solid successes of the first round, and would also strengthen the tax incentives available to businesses in the designated communities (including the brownfields tax incentive, additional section 179 expensing for small businesses, and new tax exempt bonds).

The Treasury Department will be submitting written testimony to the Subcommittee on these matters.

FOR IMMEDIATE RELEASE
July 25, 1996

**WRITTEN STATEMENT OF DONALD C. LUBICK
ACTING ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT
HOUSE COMMITTEE ON WAYS AND MEANS**

Madame Chair and Members of the Subcommittee:

In its announcement of this hearing on June 21, 1996, the Subcommittee indicated that among the provisions it would consider were the tax treatment of environmental remediation costs and incentives for locating businesses in empowerment zones. I am pleased to present the Administration's views on these two topics.

The Administration is engaged in a variety of efforts to encourage cleanup and redevelopment of economically distressed sites. Earlier this year in his State of the Union Address, President Clinton called for targeted tax incentives to help accomplish these goals, and included such initiatives, fully paid for, in his Fiscal Year 1997 Budget.

The President's brownfields tax incentive is intended to spur the cleanup and redevelopment of thousands of contaminated sites, and together with the new Empowerment Zone and Enterprise Community proposal, will help to rebuild neighborhoods, create jobs, and restore hope to our nation's cities and distressed rural areas.

Congressman Rangel has introduced the President's brownfields and Empowerment Zone proposals as H.R. 3747. Senators Mosely-Braun, Jeffords, and D'Amato have introduced a companion measure in the Senate, S. 1911. The Administration strongly urges the Subcommittee to favorably consider these proposals.

Environmental Remediation Costs

Background. Under current law, costs incurred for new buildings or for permanent improvements made to increase the value of any property (including amounts incurred to prolong the useful life of property or to adapt property to a new or different use) are not currently deductible, but must be capitalized. This general capitalization requirement covers both purchases and improvements to currently owned assets, but does not apply to repairs (which are generally deductible when incurred with respect to business property as ordinary and necessary business expenses).

President's Proposal. The President has proposed a targeted tax incentive to clean up "brownfields" -- abandoned, contaminated industrial or commercial properties that are less contaminated than Superfund sites, but still face barriers to redevelopment. Under this proposal, certain remediation costs would be currently deductible if incurred with respect to a qualified site.

This incentive is expected to cost approximately $2 billion while leveraging $10 billion in private cleanups nationwide and returning to productive use as many as 30,000 brownfields. It will also improve environmental and public health protection, and spur economic development. It has been designed specifically to affect land use in a positive way in distressed urban and rural areas.

Details. Generally, the expenses that would be deductible under the President's proposal are limited to those paid or incurred in connection with the abatement or control of environmental contaminants. For example, expenses incurred with respect to the demolition of existing buildings and their structural components would not qualify for this treatment except in the unusual circumstance where the demolition is required as part of ongoing remediation.

Qualified sites would be limited to those properties that satisfy use, geographic, and contamination requirements.

1. The use requirement would be satisfied if the property is held by the taxpayer incurring the eligible expenses for use in a trade or business or for the production of income, or the property is of a kind properly included in the inventory of the taxpayer.

2. The geographic requirement would be satisfied if the property is located in:

-- any census tract (or comparable area) that has a poverty rate of 20 percent or more;

-- any other census tract (i) that has a population under 2,000, (ii) 75 percent or more of which is zoned for industrial or commercial use, and (iii) that is contiguous to one or more census tracts with a poverty rate of 20 percent or more;

-- an area designated as a federal Empowerment Zone or Enterprise Community, including the 104 designated on Dec. 21, 1994, and the additional 102 that would be designated under the President's proposals described below; or

-- an area subject to one of the 40 Environmental Protection Agency (EPA) Brownfields Pilots announced prior to February 1996 .

These qualified sites encompass roughly 30 percent of the country. Both urban and rural sites would be eligible, though Superfund National Priority listed sites would be excluded.

3. The contamination requirement would be satisfied if hazardous substances are present or potentially present on the property. Hazardous substances would be defined generally by reference to sections 101(14) and 102 of the Comprehensive Environmental Response Compensation and Liability Act (CERCLA).

To claim this deduction, the taxpayer must obtain a statement that the site satisfies the geographic and contamination requirements from a State environmental agency designated by the EPA for such purposes. It is anticipated that in States with voluntary cleanup or similar programs, this process will be handled by the State or local agency overseeing that program. With respect to other States, it is anticipated that EPA will provide the necessary statements until appropriate State agencies are designated to take over that task.

This deduction would be subject to recapture under current-law section 1245. Thus, any gain realized on disposition generally would be treated as ordinary income, rather than capital gain, up to the amount of deductions taken. This recapture rule is limited to deductions claimed under this provision. Environmental cleanup expenses that are deductible under current law would not be subject to recapture. No inference is to be drawn from this proposal regarding the proper tax treatment of any expense under current law.

The deduction, which would apply for alternative minimum tax purposes as well as for regular tax purposes, would be effective for eligible expenses incurred after the date of enactment.

Empowerment Zones and Enterprise Communities

Background. In the Omnibus Budget Reconciliation Act of 1993 (OBRA '93), Congress authorized a federal demonstration project in which nine empowerment zones (EZs) and 95 enterprise communities (ECs) would be designated in a competitive application process. State and local governments jointly nominated distressed areas and, along with community participants, proposed strategic plans to stimulate economic and social revitalization. The response of communities was dramatic, with over 500 applications submitted by the June 30, 1994, deadline. According to a large number of applicants, significant benefits were realized from going through the application process itself. On December 21, the Secretaries of Housing and Urban Development (HUD) and Agriculture designated the nine EZs (six in urban areas and three in rural areas) and 95 ECs (65 in urban areas and 30 in rural areas).

Among other benefits, certain businesses located in EZs are eligible for three federal tax incentives: an employment and training credit; an additional $20,000 per year of section 179 expensing; and, a new category of tax-exempt private activity bonds. Certain businesses located in ECs are eligible for the new category of tax-exempt bonds. OBRA '93 also provided that federal grants would be made to designated areas.

These federal tax incentives are one component of the efforts to encourage increased economic activity and the revitalization of the distressed areas. While the tax incentives in and of themselves may have only indirect impact on land use, there are numerous non-tax elements of the designated communities' strategic plans that are likely to have a significant impact on land use, including initiatives aimed at improving educational and training opportunities, transportation, day care, housing, crime prevention, and environmental safety.

President's Proposal. Given the early success of these efforts and their tremendous promise, the Administration believes that the number of authorized empowerment zones should be expanded, subject to budgetary constraints. Extending tax incentives to economically distressed areas will help stimulate revitalization of these areas. Accordingly, the President's Fiscal Year 1997 Budget proposes to authorize the designation of additional Empowerment Zones and Enterprise Communities, with new tax incentives, including the brownfields initiative, additional small business expensing, and new private activity bonds.

Details. The President has proposed a three-part expansion of the of the federal empowerment zone proposal:

1. Two additional urban EZs could be designated under the OBRA '93 criteria within 180 days of enactment. Qualifying businesses in these areas would be eligible for the same tax incentives available to businesses in the EZs designated on December 21, 1994.

2. The OBRA '93 criteria would be modified to allow a broader range of businesses to borrow the proceeds of the tax-exempt bonds and, in empowerment zones, to qualify for the additional section 179 expensing. However, the requirements that at least 35 percent of a business's employees be zone residents, and that the tax-exempt bonds be applied against the State volume caps, would remain unaltered. These changes would be effective for bonds issued after the date of enactment and, with respect to expensing, for taxable years beginning on or after the date of enactment.

3. The designation of twenty additional EZs and 80 additional ECs would be authorized. Among the 20 EZs, 15 would be in urban areas and 5 would be in rural areas. The 80 ECs would be divided between 50 urban areas and 30 rural areas. The designations would be made before January 1, 1998.

The eligibility criteria for these new zones and communities would be expanded slightly. First, the poverty criteria would be relaxed somewhat, so that unlike the first round, there would be no requirement that at least 50 percent of the population census tracts have a poverty rate of 35 percent or more. In addition, the poverty criteria will not be applicable to areas specified in the application as developable for commercial or industrial purposes (1,000 acres in the case of an enterprise community, 2,000 acres in the case of an empowerment zone), and these areas will not be taken into account in applying the square-mileage size limitations (20 square miles for urban areas, 1,000 square miles for rural areas).

Nominations of rural census tracts (or comparable areas) that exceed 1,000 square miles in size or that include a substantial amount of governmentally owned land may exclude such excess mileage or governmentally owned land. Unlike the first round, Indian reservations will be eligible to be nominated (and the nomination may be submitted by the reservation governing body without the State government's participation). The Secretary of Agriculture will be authorized to designate up to one rural empowerment zone and five rural enterprise communities based on specified emigration criteria without regard to the minimum poverty rates set forth in the statute.

The second-round EZs would have available a different combination of tax incentives than those available to first-round EZs. The additional section 179 expensing, as modified above, and the proposal to provide tax incentives for remediation of "brownfields" to zones and communities (described above) would be available in the second-round EZs. Enterprise zone businesses in the second-round EZs would also be eligible for a new category of tax-exempt financing. These bonds, rather than being subject to the current State volume caps, will be subject to zone-specific caps. For each rural empowerment zone, up to $60 million in such bonds may be issued. For an urban empowerment zone with a population under 100,000, up to $130 million of these bonds may be issued. For each urban empowerment zone with a population of 100,000 or more, up to $230 million of these bonds may be issued. The empowerment zone employment credit will not be available to businesses in the new empowerment zones, and the increased expensing under section 179 will not be available in the developable acreage areas of the second-round empowerment zones.

The additional ECs would have available the same tax incentives that apply to the existing communities (including the private-activity bond modifications and "brownfields" tax incentives included in these proposals).

STATEMENT OF BARTOW S. SHAW, JR.
FOR THE
AMERICAN FOREST & PAPER ASSOCIATION
AND THE
FOREST INDUSTRIES COUNCIL ON TAXATION
ON THE IMPACT OF TAX LAW ON LAND USE
SUBMITTED TO THE
SUBCOMMITTEE ON OVERSIGHT
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES
JULY 16, 1996

My name is Bartow Shaw. I am Chairman of the firm of Shaw, McLeod, Belser & Hurlbutt, Inc. of Sumter, South Carolina. We are a forestry consulting firm managing timberland primarily for non-industrial landowners. I am, also, a timberland owner myself. I am a member of the Board of Directors of the Forest Industries Council on Taxation, the national trade association which represents the forestry industries and non-industrial landowners on all federal forestry tax issues. In addition, I have served on the Board of Directors of the American Forest & Paper Association, the national trade association of the forest products and paper industry. AF&PA represents a vital national industry which accounts for over 7 percent of the total U.S. manufacturing output and employs some 1.6 million people. I wish to thank you for providing me the opportunity to submit to the Subcommittee this statement about the impact of tax law on land use, an issue that is vitally important to tree growers and landowners throughout the nation.

Forest owners are located in nearly every region of the nation. They own 350 million acres of woodlands, encompassing more than 72 percent of all commercial forests. The typical non-industrial landowner is not a wealthy individual, owning an average of less than 50 acres of woodland and with an average household income of less than $50,000 per year. Our firm has served hundreds of non-industrial clients for almost three decades, and I can relate from experience that a great many of them now face a return much lower than expected when they invested in reforestation because of the Tax Reform Act of 1986 and its treatment of capital gains.

Since its enactment in 1944, capital gains treatment for timber dispositions has resulted in impressive gains in planting and productivity. However, tree planting has suffered a continual declining trend since 1986. I feel the increase in capital gains rates has been a major factor in causing this decline.

A more limited timber supply will lead to significantly greater pressure to increase timber removals from public lands at a time when those harvests are being reduced for a variety of reasons. I believe we are just now beginning to see the effects of a shift in timber harvest from the Pacific Northwest lands to the Southeast. Because of the time required to effectively create sustainable forests to meet the demands of the market, we need to urgently put the tax policy in place <u>now</u> before demand for product puts our resource in a position where it is impossible to catch up. Unfortunately, I feel more comfortable about the future value of the timber and the demand for products derived from that resource than I do about a consistent tax policy that will last the lifetime of the investment. Tree farmers who planted trees 25 years ago have seen the treatment of capital gains change several times. Many of them now ask, why invest in something so risky and for such a long period of time if taxes will eat away most of the profit? In my opinion, the federal government should develop a relatively stable tax policy to favor sustainable management of nonfederal forests.

The Balanced Budget Act of 1995 contained provisions drafted by Chairman Archer which would have cut the tax rate on capital gains for both individuals and corporations. This provision would have encouraged long-term investments and risk taking, which timber growing certainly is. Any improvement in the climate for long-term investments, we feel, would be a step in the right direction.

The second area of tax law that is having a devastating effect on land use in our industry is the current federal estate tax. As I mentioned earlier, timber growing is a long-term illiquid endeavor with many, many risks. Many family owned tree farms and small businesses are being destroyed by the federal estate tax. Inflation in land values has pushed otherwise modest businesses and tree farms into the top estate tax brackets. Although the average individual tree farmer earns a modest income, on paper his tree farm can be valued at well over $2 million, including the value of mature and harvestable timber. In many cases, when the heirs are presented the estate tax bill, they are forced to harvest their timber prematurely, sell a portion of the farm, or liquidate the entire property. Many of these productive tree farms located near large metropolitan areas are now subdivisions or shopping areas. That certainly is a change in land use, perhaps not for the better.

In closing, I would like to thank the members of this Subcommittee and the full Ways and Means Committee for having this hearing on tax law's impact on land use. It represents a commitment to a federal tax policy that will provide future generations the multiple benefits from America's privately-owned forests.

Statement of the

American Institute of Architects

The American Institute of Architects (AIA) is the professional society representing this nation's architects. On behalf of its members, the Institute submits the following comments on land use and tax reform to the U.S. House Ways and Means Subcommittee on Oversight.

It is an architect's challenge to envision the "big picture" and to attain it by piecing together many components in a manner that maximizes form, function, and value. Architecture is a balance of poetics and pragmatics.

As our country has grown, the issue of wise land use and development has become increasingly difficult to address. Now, more then ever, when fiscal resources are scarce and open spaces are dwindling, it is imperative that the nation and our localities make decisions about the development of neighborhoods, commercial areas, schools, recreation facilities, and infrastructure. Urban sprawl has become the norm, and low-density development has overtaken the landscape, imposing enormous and inefficient dollar and resource costs for water, sewer, and power infrastructure.

One way to slow urban sprawl and control the mass exodus from this nation's cities is to provide incentives for businesses to remain in urban areas. Businesses serve as community anchors, offering employment opportunities, generating tax revenue and local spending, providing services, and attracting residents and more businesses in turn.

The Commercial Revitalization Tax Credit (CRTC), H.R. 2138/S. 743, introduced by U.S. Congressman Phil English in the House and U.S. Senator Kay Bailey Hutchison in the Senate, would provide such an incentive to businesses, encouraging investment in economically distressed areas. Similar credits already in effect for related purposes such as housing and historic preservation bear this out.

We urge the Members of this Subcommittee to join the 44 House cosponsors of H.R. 2138 in endorsing this bill.

The legislation permits a choice between two available tax credits that may be carried forward or backward against tax obligations. The first choice is a credit equal to 20 percent of eligible construction and related expenses. The entire credit may be used in a single tax year.

The second option allows a taxpayer to apply five percent of eligible expenses to the annual tax liabilities over a ten year period. The legislation encourages significant investment, so routine maintenance would not be an eligible expense, nor any expenditure less than 25 percent of the tax basis of the building or project. Creditable expenses would have a lifetime limit of $10 million per project. Total available credits would be $1.5 billion over five years following enactment.

It would be paid for in three ways--claiming a small slice of tax reductions that Congress has decided to enact; generating economic activity that returns money into the Treasury; and shifting resources from untargeted programs such as the 10 percent rehabilitation tax credit.

Monies would be allocated directly to the states according to a formula, based on population. The states would have the freedom to establish their own programs, although the legislation anticipates that projects awarded credits would be chosen based on their fulfillment of strategic plans developed under a public participation process, and their potential to create permanent jobs.

Businesses eligible for the commercial tax credit could be located in existing federal Empowerment Communities/Enterprise Zones (EC/EZs), state EC/EZ's or their equivalent, or any revitalization area established by federal, state, or local law that contains a population of which at least 50 percent earn less than 60 percent of the median area income. About 500 communities that applied for EC/EZ designation from the federal government were not selected. Most of these places have quality revitalization programs ready to implement, given sufficient incentives to attract private capital.

The AIA believes CRTC is well-targeted, built on proven and accepted mechanisms for delivering tax incentives. The proposal is designed to reward success: eligible projects must be included in a locally developed strategy for revitalization and long-term sustainability, and the credit may not be taken unless the business is generating taxable revenue and the commercial structure is actually placed in service. It would operate with a minimum of bureaucracy, complement other incentives, leverage existing infrastructure, and put buildings that are economic and social liabilities back into productive use.

If one examines similar credits, it is clear that the proposed CRTC has significant potential for encouraging investment in places businesses left years ago. The Low-Income Housing Tax Credit Program (LIHTC) provides $320 million in credits per year, which generates $2.8 billion a year in wages and salaries and $1.3 billion in tax revenues. It also creates about 110,000 jobs in construction and related industries.

Another related tax credit is the historic rehabilitation tax credit, which may be applied to historic properties on the National Register of Historic Places. This credit provided $97 million in FY 1994, generated $483 million in private investment, and created 21,000 jobs. Both of these credits contribute significantly to the betterment of communities and neighborhoods.

An effective capital-based incentive for non-historic commercial projects in targeted areas is a missing piece of the incentive package that must be made available to reduce the risk of investment. The CRTC is not a panacea. It cannot in and of itself solve the problems of economically distressed communities and urban sprawl. It can, however, tip the balance for a business considering expansion or new development in existing neighborhoods.

The AIA believes the CRTC represents a feasible, common sense solution to the inefficient use and inappropriate placement of this nation's resources. We commend the Chairwoman for addressing this issue and exploring alternative options sooner rather than later, and the AIA stands ready to work with the Subcommittee in the future. Thank you.

Written Statement of

AMERICAN VINTNERS ASSOCIATION
by
Simon Siegl
President

Submitted for the

SUBCOMMITTEE ON OVERSIGHT
of the
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

HEARING ON THE IMPACT OF TAX LAW ON LAND USE

July 25, 1996

Introduction

Chairwoman Johnson and Members of the Subcommittee, thank you for allowing the American Vintners Association ("AVA") to submit testimony relating to the impact of tax law on land use. The AVA is a national trade organization of American vintners with a membership of over 500 wineries in 42 states. We appreciate the opportunity to discuss one of the major land use issues currently faced by farmers, vintners, and other crop owners. The problem we would like to address relates to the financial burden that farmers face when their crops are damaged by disease or natural disaster.

As described below, the devastating impact of phylloxera and frostkill on the wine producing industry is a prime example of the harmful effects that natural disasters can have on land use, both economically and environmentally. Crop owners attempting to recover from such losses often face insurmountable costs, resulting in long periods of inactivity for the farm or vineyard. Such nonuse significantly weakens the economic stability of the industry, and can also damage the land itself, especially when the land is converted to less beneficial uses during the period of inactivity.

In 1986, Congress recognized the severity of this burden and enacted section 263A(d)(2) of the federal tax code, which allows farmers to deduct certain casualty expenses. Unfortunately, the IRS has adopted an excessively narrow interpretation of this statute, preventing crop owners from claiming the tax benefits that section 263A(d)(2) was intended to provide. Because of the restrictive reading imposed by the IRS, many farmers are unable to recover from the severe losses caused by natural disasters.

Congressman Bill Thomas (R-CA) has introduced a bill, H.R. 3749, that would clarify the appropriate interpretation of the 1986 farm casualty rule for deducting the costs of replanting destroyed crops. The American Vintners Association urges the Committee to adopt this important legislation.

Impact of Natural Disasters on Crop Owners and Land Use

Natural disasters can have a catastrophic effect on farmers whose crops do not reach marketable production until many years after planting. When diseases or other severe conditions destroy a farm or vineyard, crop owners must invest large amounts of money to restore their businesses to working condition. Banks and other financial institutions are reluctant to take the risks involved with replanting, particularly when weather and other natural disasters may destroy the crops again. Furthermore, even when the damaged property is replaced, it may take another three to four years before a commercially harvestable crop can be obtained, thereby eliminating any revenue from the farm or vineyard for an extended period of time. Finally, periods of nonuse due to economic hardship can cause environmental damage to the land itself.

While wine producers and grape growers are not the only ones impacted by such losses, their situation provides a good illustration of how such natural disasters negatively impact both crop owners and their lands. Wine producers and grape growers across the country have been faced with severe damage caused by pests and extreme weather conditions. In the wine growing regions of New York, Pennsylvania, Ohio, Michigan, Missouri, and Arkansas, low temperatures lead to "frostkill" -- a weakening of the vines which kills crops or leaves them vulnerable to disease and infestation. The affected vines must be removed and replaced in order for grape production to continue.

Crop owners in California and Oregon, similarly, have been faced with severe damage caused by a pest known as phylloxera. Phylloxera is a small aphid-like louse which, because it is impervious to pesticides, can be eliminated only be removal of the infested vineyards (including irrigation equipment, drain tiles, and trellis systems) and the subsequent fumigation and replanting of vineyards with root stocks resistant to the pest. Furthermore, the Department of Agriculture has stated that the failure of a grape grower to eliminate the phylloxera from one vineyard could have devastating consequences for vast areas of vineyards.

Wine producers faced with a natural disaster such as phylloxera or frostkill must generally replace entire vineyards in order to salvage their business. However, vines and root stock cannot be removed without removing related improvements, since the irrigation equipment, trellis systems, and drain tiles are inextricably linked with the mature vines and root systems. Furthermore, once a vineyard is removed and replaced, it still takes many additional years for the vineyard to reach its pre-casualty maturity level and revenue generation capability.

The huge costs required to replant devastated vineyards have forced many farmers to keep their land lying fallow or used for less environmentally beneficial purposes. Vineyards are a uniquely benign form of land use, because they require very minimal amounts of water compared to other crops and because they employ integrated pest management and other "sustainable agriculture" practices. Therefore, when nonproductive vineyards are converted to alternative land uses, environmental harm -- in addition to economic damage -- inevitably results.

Congressional Intent and the Farm Casualty Rule

Section 263A of the tax code, enacted as part of the Tax Reform Act of 1986, generally requires a taxpayer engaged in a farming business to capitalize all costs that are incurred in manufacturing or constructing tangible personal property. However, recognizing the burden faced by crop owners dealing with natural disasters, section 263A(d)(2) provides an exception for costs that are incurred by a taxpayer whose crops are destroyed by certain casualties. Specifically, section 263A(d)(2) allows a taxpayer to deduct "any costs" incurred for "replanting plants bearing the same type of crop" after a crop has been damaged "by reason of freezing temperatures, disease, drought, pests, or casualty."

The plain meaning of this statute indicates that Congress intended the farm casualty rule to alleviate the tax burden that farmers face when their crops are destroyed by disease or natural disaster. Despite this statutory language, however, the IRS has adopted an unduly narrow interpretation of section 263A(d)(2).

Under the IRS reading of the law, a grape grower whose vineyard has been destroyed by disease or natural disaster may not deduct the costs of vines, vinestock, soil fumigation, trellises, irrigation equipment, or drainage systems. The IRS reading of the law limits casualty deductibility to preproductive period expenses, forcing most costs to be capitalized.

The Solution: Amend the Code to Allow Deductibility

H.R. 3749, the measure introduced by Rep. Thomas, would amend section 263A(d)(2) to help ensure that farmers are able to finance their replanting costs, thereby curbing the negative impact on land use that such natural disasters can have. The bill would allow taxpayers to deduct certain expenditures, incurred after December 31, 1995, for replanting destroyed crops.

A number of special rules are included in this bill to ensure that abuses do not occur. The bill allows continued deductibility of all preproductive period costs. However, in recognition that some improvements might be made during the replanting process, certain costs, referred to as "special replanting costs," would only be 80 percent deductible. Such costs would include tangible assets such as plants and their supporting structures, and irrigation and drainage systems where such systems were destroyed during removal of the damaged plants. The bill includes a clear definition of "preproductive costs," and includes language to prevent taxpayers from receiving a double benefit by taking loss deductions on the same expenditures which are subject to this rule.

We believe that enactment of this legislation is the only feasible way to ease the insurmountable burden faced by many crop owners, and to ensure that the farm casualty rule is interpreted appropriately. On behalf of the American Vintners Association and the entire wine industry, we thank the Subcommittee for the opportunity to testify on H.R. 3749 and its impact on land use. Please do not hesitate to contact us if we can provide you with any additional information on this important issue.

Submission to
The Committee on Ways and Means
Subcommittee on Oversight
Hearing on
Impact of Tax Law on Land Use
By Thomas Bier

My name is Thomas Bier. I am director of the Housing Policy Research Program at Cleveland State University, Cleveland, Ohio, a position I have held for 14 years. Since I am unable to attend the hearing on July 16, 1996, I wish to submit the following statement.

Research I have done indicates that Section 1034 of the IRS Code promotes movement of homesellers out and away from central cities and obstructs movement inward. The effect of that is to promote the outward sprawl of metropolitan areas, and to undermine the fiscal strength of central cities.

Sec. 1034 concerns capital gain realized through home-ownership. If a home increases in value the gain is taxable at the time of sale -- unless the seller purchases another home of equal or greater value. In that case tax liability is postponed (or rolled over).

The postponement can extend through any number of moves as long as the price of each home that is purchased at least equals the price of the home sold.

At age 55 the homeowner qualifies for a one-time tax exemption. The owner can then sell, not purchase another home of equal or greater value and not have to pay tax on up to $125,000 of capital gain over and above the purchase price of the first home. (That provision provides needed capital for many retirees.)

The origin of Sec. 1034 was the Revenue Act of 1951. During the Cold War build-up, industry employers were finding that their need to move employees around the country was being impeded by the taxation of homeseller capital gain. At that time no one could have anticipated that the new capital gain provision, meant to free movement between cities, would eventually restrict movement within cities, or metropolitan areas.

The requirement that a seller purchase a home at least equal in price to the one sold in order to avoid being taxed is a major incentive not to move down in price. If a city's home prices happen to be lower than prices in surrounding suburbs (and usually they are), the law is a serious obstacle to moving into the city -- irrespective of other possible obstacles such as concern over crime or quality of schools.

The problem is not just the city's. The law discourages sellers at all price levels, city and suburban, from moving down in price, thereby restricting the housing choices available to them, and it encourages them to move up in price. Typically moving up means moving further out.

The more that the geographic pattern of home values across a metropolitan area is one of increasing value with distance from the center, the more that city and suburban sellers will move outward. The more they do that, the more that sprawling outer suburban development will occur, and the more that city (and eventually inner suburban) decline will result.

Our study (report enclosed) of the geographic pattern of home values and the movement of sellers in the Ohio metro areas of Akron, Cincinnati, Columbus, Cleveland, Dayton, Toledo and Youngstown confirmed the expected patterns.

> 90 percent of the city sellers, and 75 percent of the suburban sellers, moved further out to buy their next home.

> 80 percent of all sellers met the capital gain provision (bought a home priced at least equal to the one sold), 84 percent of whom moved further out and 16 percent moved closer to the city center.

> Of the 20 percent who did not met the provision, 64 percent moved further out while 36 percent moved closer in.

Those who did not comply moved inward at a rate 2.3 times greater than those who did comply (36 percent vs. 16 percent), which suggests the possibility that more would move inward were it not for the capital gain provision.

Not only does Sec. 1034 foster urban sprawl and central city decline by obstructing movement down in price, it also disadvantages homeowners who are forced to move down because of personal circumstances such as illness or employment change to a lower level of income. The code penalizes those least able to absorb it.

For those reasons Sec. 1034 should be revised to remove the penalty against moving down in price; allow movers to go freely up or down until aged 55 (or older) after which they can settle up with IRS on their net gain, using the $125,000 exemption.

Better still would be to remove the tax on homeseller capital gain all together. It would cost the treasury something (I've heard an estimate of about $3 billion) but most gain now is little more than inflation. Most homeowners may be lucky to stay even with inflation.

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California Farm Bureau Federation
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Statements of the
California Farm Bureau Federation

To
The House Ways and Means
Subcommittee on Oversight
The Honorable Nancy L. Johnson, Chair

Regarding

IMPACT OF TAX LAW ON LAND USE

July 16, 1996

The California Farm Bureau Federation (CFBF) is the largest general farm organization in the state. We have more than 42,000 member farm families and more than 72,000 member families in total. Nationwide our views are reflected by the American Farm Bureau Federation, which represents more than four million members. We appreciate the opportunity to provide a statement in support of changes that are needed in the tax code to ensure that the business of family farming may continue for generations to come. This subcommittee and Congress have an excellent window of opportunity to address the implications of federal tax policy on land use in a very constructive and meaningful way.

FEDERAL ESTATE TAXES

Often under current tax laws a farm must be sold in part or total to satisfy estate taxes. Many of these farms are multi-generation family businesses. The agriculture industry is dependent on the ability to pass the family farm down from generation to generation. Without changes in the estate tax law, it will be difficult to maintain family farming as we know today. Federal estate tax law has the ability to close family farm operations and shift agriculture land into other uses.

Last updated in 1987, the per person exemption for assets under federal estate tax law is $600,000 for the value of an estate. CFBF has long called for the elimination of the estate tax, or at least, an increase in the exemption to $2 million along with future indexing. Years of inflation have outdated existing estate tax laws. Estate tax relief would encourage new investment, increased savings, and the removal of disincentives to pass on family farming and small business operations.

CFBF policy supports an increase in the ceiling allowed in determining the existing exemption under Internal Revenue Service Code 2032-A for agriculture productive value. This provision allows for land to be valued for estate tax purposes at its agricultural value rather than its market value. Due to the nature of California land values, the current limitation of $750,000 is not adequate. Removing the limit would reduce the potential for land to change uses to meet the cost of estate taxes.

CAPITAL GAINS TAXES

Many farmers and ranchers nearing retirement are interested in selling land to younger farmers and ranchers, including family members, but are inhibited by current capital gains tax law. Farmers pay capital gains taxes when they sell their land. Farmers typically hold their land for long periods of time. The national average is 28.6 years and over this period the value of total farms real estate in the U.S. has increased 4.27 times. The increase has been due to nothing more than inflationary gains. For tax purposes, the gain from the sale or exchange of an asset held more than one year is characterized as a long-term capital gain. For individuals, current law taxes capital gains as ordinary income at 28 percent. The current capital gains tax treatment results in an inordinately high level of farm lands held by absentee land owners -- widows and retirees.

In California, many farm commodities such as timber, Christmas trees, breeding livestock, dairy cows, and equine have extended production cycles making them subject to capital gains treatment. The capital gains tax creates a disincentive for farmers to upgrade farm operations because taxes must be paid on farm assets sold to finance improvements. Unimproved farm businesses are less efficient and less profitable.

The United States has among the highest capital gains tax rates in the world. We support elimination of the capital gains tax, or at the very least, a maximum tax rate of 15 percent, indexed for inflation. This much needed reform would facilitate land transfers and the movement of capital assets to beginning farmers and ranchers. Capital gains tax relief would allow many older farmers and ranchers who are delaying selling their assets because of the tax, which results in the reduction of land available to new producers, to do so.

The capital gains tax is a direct obstacle to better land management because it discourages infill development and redevelopment of abandoned or under-utilized property in urban areas. Capital gains relief would provide an incentive to landowners to either sell, develop, or improve urban property so that it can be used more intensively.

A major hurdle to greater utilization of existing urban infrastructures and more efficient use of land is the tax disincentive to sell or improve real estate holdings. Owners of real property with low capital gains basis have little desire to sell their land. By providing a substantial shelter for capital gains income derived from the sale of qualified property, infill and redevelopment could be enhanced.

FARMERS AND RANCHERS INDIVIDUAL RETIREMENT ACCOUNTS

CFBF supports farmers and ranchers ability to achieve retirement security without having to sell their land for development. In order to achieve security, fully deductible Individual Retirement Accounts (IRA) for qualified farmers and ranchers, up to a set percentage of their Schedule F income should be provided. In agriculture especially land holding typically represents most of the owners life savings and when they do sell, they pay taxes on their investment as a lump sum at a much higher rate than people who can withdraw their retirement savings over time.

One of the primary obstacles to long-term agricultural land conservation is the need from elderly farmers and ranchers to base their retirement on the cash equity in their land. Under this proposal, filers of Schedule F who derive at least 75 percent of their income from farming and ranching would qualify to fully deduct their IRA investments up to 10 percent of their net farming income.

We will continue to work for a reduction in both estate and capital gains taxes, the establishment of Individual Retirement Accounts for farmers, and the protection of agriculture lands.

Once again, thank you for the opportunity to submit a statement to the subcommittee. We welcome any assistance that you may provide in supporting the continuation of family farmers and ranchers ability to pass the business down from generation to generation.

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STATEMENT BY DR. STEVEN CORD FOR C.S.E. ON THE

IMPACT OF FEDERAL TAX LAW ON LAND USE

BEFORE THE H.R. COMMITTEE ON WAYS & MEANS, 7/11/96

The federal government should encourage state & local governments to shift as many of their taxes as possible to the assessed value of land, for these reasons:

(1) State & local governments penalize building ownership, retail sales and income when they tax such desirable things. Such taxes hurt the economy and cause the federal government to levy high income taxes to fund government programs.

(2) Governments should get their revenue by taxing land assessments instead. Such a tax encourages land owners to develop their sites in order to obtain an income from the improvement which can pay the higher land value tax as well as for the improvement also, thereby creating jobs and economic growth). Here is a revenue source that actually promotes economic growth at no extra tax cost to the taxpayer ("no extra tax cost" because only a tax shift from buildings to land is involved). By promoting tax-free urban rejuvenation, we will be containing urban sprawl into the clean-and-green countryside.

In the 21st century, the payment of the general budget debt and Social Security benefits will absolutely require such a tax (since it promotes land development), but these are ways by which the federal government can encourage state & local governments to levy such a tax now:

o H.U.D. and D.O.T. can condition state & local grants on adoption of a land value tax (but this must be done gradually).

o H.U.D. can require enterprise zones and a new city to levy a land value tax.

o H.U.D. can promote the benefits of land value taxation to states and cities.

o The federal government can levy an income tax on annual land rent; we can advise on this, having received much experience by working with all 17 land-value-taxing cities and a school district in the U.S. And there are other ways by which the federal government can promote better land use through land value taxation.

We have performed many studies substantiating all the claims made above. About 700 cities throughout the world use land value taxation, and all studies indicate it works well. Many well-known authorities have endorsed this proposal, including seven recent American Nobel Prize winners in economics.

Now is the time for our federal government to promote better land use.

#4330

A nonprofit educational foundation

Clement Dinsmore
3726 Veazey Street, NW Washington, DC 20016-2229

July 26, 1996

Honorable Bill Archer
Chairman
Honorable Sam Gibbons
Ranking Member
House Committee on Ways and Means
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Chairman and Congressman Gibbons:

We want to express appreciation for the hearings your Committee conducted on Tuesday, July 16 through the Oversight Subcommittee on the impact of Federal tax law on land use.

The Location-Efficient Mortgage Partnership:
Using Non-Tax Incentives
To Encourage Efficient Communities

We--the Surface Transportation Policy Project, the Natural Resources Defense Council, and the Chicago-based Center for Neighborhood Technology--are partners in implementing a new approach to single family residential mortgage lending called the Location-Efficient Mortgage program. Attached are materials that describe our purposes and the general status of our efforts.

We believe that the inefficient use of land resources in this country results in the inefficient use of public and private capital and human resources and aggravates the social welfare and health costs that our society is struggling to finance.

We believe that more efficient use of land has many economic, social, environmental, and other benefits. We are embarked upon a long term effort to encourage location efficiency--the efficient location of residential, transportation, employment, commercial, institutional [such as health care, education, and job training], and public land uses relative to each other. We have created a Foundation for Location Efficiency to organize this effort.

In the shorter term we are seeking the cooperative participation of mortgage lenders and secondary mortgage market institutions in the demonstration of the Location-Efficient Mortgage program. We believe that through this program we can create non-tax financial incentives for American households to choose to live in "**location-efficient**" communities--communities with higher densities that support public transportation services and encourage the efficient proximity of places of employment, employment training, residence, health care, shopping, education, recreation, and other daily household activity.

The Federal Tax Code and Resource Use Incentives

Various provisions of the Federal tax code create incentives and disincentives that have encouraged or attempted to compensate for the historic, inefficient use of our land and other resources. These are not limited in their applicability to the activities of any one economic sector, such as housing construction and finance. They are myriad in their application to different parties.

Federal Budgetary and Revenue Gains Through Location Efficiency

Location efficiency encourages a more efficient utilization of the capital investment that already has been made in urban utilities and infrastructure necessary to household and business activities. A more efficient realization of the benefits of existing investment in turn reduces the demand for capital to finance the creation of new infrastructure, where communities do not now exist. The Federal Government would realize a major reduction in its expenditures through a decline in interest rates associated with a reduced capital demand for new urban infrastructure and utilities.

Hospitals and medical care facilities are among the urban service infrastructure that is not efficiently utilized, when development occurs inefficiently. Location efficiency would reduce the demand to create new medical care facilities in greenfields locations.

Location efficiency facilitates transportation efficiency--both for households and commercial entities. Location efficiency, therefore, helps reduce regulated air emissions and improves public health. An improvement in public health would reduce the demand for tax revenues for public health protection and medical care.

Location efficiency contemplates greater proximity of household residences to places of employment. This encourages greater accessibility of all persons, including lower income households, to job opportunities and reduces costs to employers of employee turnover, absenteeism, and late reporting for work. An increased participation of lower income households in the work force would reduce the demand for Federal and State welfare support expenditures.

An increase in location efficiency in this country would reduce the tax cost of proposals before your Committee to protect undeveloped "greenfields" and to remediate contaminated "Brownfields." Continued inefficient use of land will limit market demand for Brownfields and maintain market demand for the conversion of greenfields to urban uses. The tax cost of proposals to protect greenfields and remediate Brownfields will be greater, if market demand for greenfields does not decline and demand for Brownfields does not increase. On the other hand, increased efficiency in land use would help relieve market demand for greenfields and improve demand for Brownfields and thereby reduce the tax cost of greenfields protection proposals and Brownfields remediation proposals.

An increase in location efficiency, also, would enhance the ability of more American households to increase their financial wealth and gain access to private sector financial resources. The location-efficient mortgage program is premised upon the ability of households in location-efficient communities to reallocate their disposable income from transportation to housing expenditures. The program is designed to facilitate household access to mortgage credit and acquisition of an equity interest in residential real estate. As real estate values improve over time, that equity enables households to increase their wealth and gain access to greater credit for other purposes, such as education. Improvement in the financial well-being of American households in turn would reduce the demand for Federal tax revenues to finance household expenditures--health, education, retirement, or other.

Many of the financial incentives in the Federal tax code attempt to compensate for private markets' inattention or inadequate financing of the costs of publicly desired goods and services. If we were able to create new, **non-tax** incentives for creating communities with greater location efficiency, we would hope that, as these incentives gained market acceptance and enhanced the feasibility of delivering housing to more households at less cost, we could begin to reduce certain tax incentives that support financing shelter costs that are inflated by the inefficient use of land and building materials. Tax revenues would increase, as the tax subsidy was reduced.

Conclusion

We encourage your Committee's continued review of the Federal tax code for provisions that discourage the efficient organization of the economic, physical, and human environments of American communities. We will be happy to contribute to the Committee's analysis and suggest tax code modifications.

Through non-tax financial incentives we mean to reward American households that choose to live in communities that enable them to conduct their daily lives in an efficient manner. We encourage the Committee to consider how non-tax incentives may be substituted for tax incentives to achieve policy objectives.

The inefficiency of the physical environment that we have created in this country imposes economic, social, personal, and environmental costs upon our citizens. Many of these costs now are apparent. Our citizens' economic opportunities are limited, their tax burden is aggravated, and their physical and emotional health is impaired by the inefficient use of our natural, human, and financial resources.

Sincerely,

Clement Dinsmore on behalf of
The Location-Efficient Mortgage
Partnership

Enclosures
cc: Honorable Nancy Johnson
Honorable Robert Matsui

THE LOCATION EFFICIENT MORTGAGE PARTNERSHIP

THE PARTNERS: The Location Efficient Mortgage Partnership includes the Surface Transportation Policy Project, the Center for Neighborhood Technology [Chicago], and the Natural Resources Defense Council. The Federal Transit Administration and Environmental Protection Agency are funding the Partnership's single family loan program research and development.

WHAT AND WHERE: The Partnership--using data for the Los Angeles, San Francisco, and Chicago metropolitan areas--is finetuning an analytical model developed by John Holtzclaw, consultant to the Partnership, that correlates household geographical location with relative transportation efficiency and household transportation expenditures relative to other locations within the metropolitan areas.

The Partnership--focused initially upon Los Angeles, San Francisco, and Chicago--is actively exploring with single family residential mortgage lenders and secondary market entities the utility of the analytical model in identifying affordable housing loan market opportunities for lenders in "transportation [or location] efficient areas"--areas that by reason of their greater dwelling unit density or access to public transportation require less household expenditure upon private automobile transportation. Households in these areas can use their transportation savings to finance the purchase of affordable housing.

WHEN AND HOW: The Partnership's goal of demonstrations of the utility of its model in support of the "location efficient mortgage" is included in the National Homeownership Strategy adopted a year ago by the National Partners in Homeownership and is endorsed by the President's Council on Sustainable Development in its first report.

The Partnership will be demonstrating the applications of its model at the first anniversary conference of the National Partners in Homeownership June 6 and 7 in Washington, D.C..

At and following the June conference the Partnership will be seeking to confirm interest of primary and secondary mortgage market lenders in demonstrating the "location efficient mortgage."

The Partnership will focus its marketing attention upon innovative, private mortgage lenders and the principal secondary market institutions, Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System, as well as State and local residential funding sources, such as State and local housing finance agencies and pension funds.

WHO BENEFITS: The Partnership intends to create explicit financial rewards for households that choose to reduce their daily transportation requirements and thereby enhance their ability to dedicate disposable income to housing rather than transportation expenditures. Creation of such rewards also will benefit employers concerned with the costs to them and their employees of inefficient accessibility of employees to employment locations.

THE LOCATION EFFICIENT MORTGAGE (LEM)

How can a mortgage affect the way our cities grow? Can the same mortgage also influence transportation policy?

The Natural Resources Defense Council (NRDC), the Center for Neighborhood Technology (CNT), and the Surface Transportation Policy Project (STPP) have joined together to demonstrate that a mortgage can indeed influence both urban growth and transportation policy, while also providing a response to the need for expanded homeownership opportunities for low- to moderate-income people. As a result, the Partnership developed the Location Efficient Mortgage (LEM), an innovative solution to encourage and facilitate homeownership in transit-accessible inner city and denser suburban areas.

The LEM is based on a 1994 NRDC study by John Holtzclaw that identifies a relationship between residential density of a neighborhood and total vehicle miles traveled per household within that neighborhood. For every 100% increase in residential density, the study shows that there is a 25% decrease in vehicle miles traveled (VMT). As areas increase in density and transit service, they become more "location efficient", since they offer easy access to stores, public transit, churches, jobs, restaurants, recreation, and other common destinations. Because of this accessibility, people drive less and own fewer or no cars. Basically, the LEM makes use of the savings derived from driving less to help people afford to buy homes in location efficient areas, such as high-density inner city neighborhoods.

HOW THE LEM WORKS: The LEM partners have developed a statistical model (based on VMT vs. residential density, transit access, and proximity to stores, jobs, etc.) that shows the dollar savings per household in a location-efficient area compared to an average household in a low-density suburb. This savings is then treated as available disposable income by adding it to the maximum monthly payment allowed by the mortgage formula banks use (new formula: PITI + Other long term debt - LEM savings < = 36%), thus enabling someone to afford a higher-priced "location-efficient" home. With the LEM, homebuyers need not be forced into distant low-density areas, where they must have a car (often one per capita). The LEM levels the playing field, allowing people who want to live in location efficient areas a simple way to afford homes normally considered out of their reach.

For example, the study shows that a typical household in the dense North Beach area of central San Francisco drives approximately 23,000 miles LESS per year than a household in Morgan Hill, a representative low-density suburb. That translates into over $400/month in lower transportation expenses for the North Beach area. Banks currently treat both areas equally, while the LEM takes this very real savings into account. (Applied to a mortgage formula, $400/month in transportation savings can equal approximately $50,000 more in borrowing power.)

The LEM model builds on Fannie Mae's Desktop Home Counselor, enabling mortgage lenders to calculate and apply the savings from location efficiency easily and inexpensively. This model provides a lender with the applicant's borrowing power after asking them only a few questions, including car ownership and location of the new home. A version of this model was demonstrated at the National Partners in Homeownership Summit in Washington, D.C. in June.

HOW THE LEM CAN MAKE A DIFFERENCE: The LEM Partnership will be working with lending institutions and secondary mortgage purchasers to make location efficiency a standard part of the mortgage lending process. For lenders, the LEM offers them an opportunity to help increase low- to moderate-income participation in the housing market. There is also the added benefit of offering an incentive to the often-neglected middle-income purchaser who might now choose to stay within the inner city. In fact, the LEM is a powerful tool for attracting these middle-income families who often decide to locate elsewhere, but could play a critical role in the economic well-being of a community as a whole.

By encouraging expanded credit access within location-efficient communities (urban or suburban), the LEM will help bring these areas a more vital housing market, and, hopefully, increased ownership opportunities, including new investment in community revitalization and infill where appropriate. (In fact, we are presently working with Mission Housing in San Francisco to use the LEM as part of an effort to create more affordable housing in the Mission District.) In addition, location efficient areas could experience concurrent commercial development, helping to create more self-sufficient communities with even less of a need for driving. Last but certainly not least, the public transportation arteries that make location-efficiency possible should receive increased support and funding as a direct result of the LEM.

THE LEM IS PART OF A LARGER EFFORT that looks at how cities can grow without putting undue strain on scarce resources and support services such as transportation, water, sewer, electric, gas, etc. By encouraging a shift toward more investment in location efficient neighborhoods, the LEM can help promote a sensible distribution of future population growth.

Long term, the LEM hopes to serve as a catalyst for promoting sustainable land use, increasing investment in public transit, and making cities and communities more livable as a whole. To be truly effective, of course, this effort must be a collaboration of government, developers, urban planners, environmentalists, community groups, and business people. We are actively working to make that multi-interest partnership a reality.

The project is currently funded by the Federal Transit Administration and the Environmental Protection Agency, with HUD and the Department of Energy also expressing an interest in providing support. The LEM is endorsed by the President's Council on Sustainable Development and is a core element of the National Partners in Homeownership Campaign.

THE LEM DEMONSTRATION, the first phase of the project, initially targets three metropolitan areas: San Francisco, Los Angeles, and Chicago. We have begun preliminary discussions with local governments whom we are asking to become our partners in the test phase of the LEM. We plan to work with several banks in each city to serve as lenders for the test and also anticipate the secondary market, including Fannie Mae, will become active partners in this venture. The First National Bank of Chicago and First Nationwide have agreed to work with us toward the submission of an application to Fannie Mae's Experimental Underwriting Initiative; they will also supply advisors to help us develop the market test for the LEM. We are looking for other interested lenders to join in this ground-breaking demonstration.

LOOKING TOWARD THE FUTURE, we expect to expand the LEM program to other metropolitan areas throughout the country; we have already received inquiries from over twenty cities. Our goal is the eventual universal acceptance of the principles of location efficiency within basic underwriting guidelines.

IF YOU ARE INTERESTED IN WORKING WITH US in the creation and implementation of this new mortgage concept, you can contact Ronnie Himmel at the Natural Resources Defense Council, 71 Stevenson Street, San Francisco, CA 94105. Her phone number is 415-777-0220 x 305.

Testimony Submitted by the

Edison Electric Institute

on

Deductibility of Asbestos Removal Costs

July 16, 1996

The Edison Electric Institute (EEI) appreciates the opportunity to submit testimony (for the Record) for the July 16 hearing on the tax code provisions that have an impact on land use. EEI is the association of our country's shareholder-owned electric utilities which serve 76% of all ultimate electric customers in the nation. EEI commends the Subcommittee on holding a hearing that addresses a number of provisions in the Internal Revenue Code which impact land use. We believe that the hearing is particularly appropriate in light of the continued uncertainty that exists with respect to deductibility of environmental remediation costs, specifically the deductibility of asbestos removal costs.

INDUSTRY PRACTICE

EEI is very concerned about the tax treatment of asbestos removal costs because electric utilities have used asbestos extensively as an insulator for steam generation electric equipment. In an electric generating plant, steam boilers produce high-temperature steam. In order to reduce heat loss, asbestos insulation is attached to the walls of the boiler and turbine electric generator, and is wrapped around all associated piping. Asbestos insulation is removed during routine inspections of the piping and turbine. Once removed, the asbestos is not reused. It is also possible that, with age, insulation will begin to disintegrate, thereby requiring total removal or encapsulation. It is generally with respect to this latter use of asbestos as insulation that federal and state occupational safety and health laws require safe removal and replacement of the material.

TREASURY/IRS POSITION

On February 10, 1994, 22 members of the House Ways and Means Committee sent a letter to the Honorable Lloyd Bentsen, Secretary of the Treasury, expressing their interest and concern regarding the appropriate treatment of environmental remediation expenditures. The letter was sent in response to two Technical Advice Memoranda (PLR 9240004 and PLR 9315004) that required taxpayers to capitalize a substantial portion of these costs. The letter emphasized that the federal tax treatment of environmental remediation expenditures is a key component to this nation's commitment to cleanup and preserve the environment. The letter also emphasized that government policy should encourage taxpayers to promptly initiate remediation activities and that the IRS interpretation of the law in this area could be a disincentive for companies to cleanup. EEI strongly endorses the tax policy principles set forth in the February 10, 1994, letter.

In response to the letter of the House Ways and Means members and submissions by EEI and others, the Internal Revenue Service (IRS) held in Revenue Ruling 94-38 that hazardous waste remediation expenses were deductible as ordinary and necessary business expenses. This ruling reversed the one technical advice memoranda (PLR 9315004) but did not reverse the other PLR (9240004) dealing with removal and replacement of asbestos insulation used to insulate equipment.

EEI had hoped that, based upon the rationale underlying Revenue Ruling 94-38, the IRS would revoke PLR 9240004 as well. Clearly, asbestos removal costs are similar to the costs incurred in Revenue ruling 94-38 for land remediation and groundwater treatment. Under Revenue Ruling 94-38 such costs are expensed. The same result should follow in the case of asbestos removal. Revenue Ruling 94-38 rejected the conclusion in PLR 9240004 that the cleanup and removal expenditures should be capitalized because the costs enhanced the value of the equipment. Revenue Ruling 94-38 also rejected the premise underlying PLR 9240004 that the costs of asbestos removal are part of a plan of rehabilitation associated with the costs of installing an alternative insulation. The cost of removal of asbestos is not incurred in connection with the installation of new insulation. It is incurred because taxpayers are required to comply with federal and state environmental laws and regulations.

CONCLUSION

Asbestos removal costs affect numerous taxpayers. For the past two years, EEI and many other organizations and corporations have been meeting with the IRS and Treasury requesting clarification on the deductibility of asbestos removal costs. No guidance has been received to date. For this reason, EEI urges the Oversight Subcommittee to encourage the IRS and Treasury to issue guidance confirming the deductibility of asbestos removal costs.

Thank you for giving EEI the opportunity to submit our statement.

Written Statement of

THE CITY OF HOUSTON
by
The Honorable Bob Lanier
Mayor

Submitted for the

SUBCOMMITTEE ON OVERSIGHT
of the
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

HEARING ON THE IMPACT OF TAX LAW ON LAND USE

July 25, 1996

Introduction: Tax Incentives for Job Creation

Chairwoman Johnson and Members of the Subcommittee, thank you for allowing the City of Houston to submit testimony relating to the impact of tax law on land use. We appreciate the opportunity to discuss the need for tax incentives to help revitalize distressed communities, including certain neighborhoods in the City of Houston.

The designation of certain distressed areas as Empowerment Zones (EZ) and Enterprise Communities (EC) in 1994 was a crucial step toward helping such communities fight poverty, crime, and unemployment by fostering economic growth. Congress and the Administration are now considering proposals to expand the EZ/EC program, thereby giving such assistance to even more communities in need. However, revitalization of blighted urban areas will be limited and lengthy at best until more focused tools are available to cities. Improvement of infrastructure needs, large scale demolition of unsafe structures, new housing developments, crime reduction strategies, etc. are all extremely important but they will not bring back to these urban areas the one missing ingredient to long term stabilization - new and expanded job creation.

Wage tax credits and brownfields clean-up incentives are two powerful tools which we believe can play an important role in bringing businesses and jobs to communities like Houston. We urge you to support the adoption and expansion of these incentives in order to help the revitalization of American cities.

The Plight of the Inner City

It is often difficult for large cities to compete with the suburbs that surround them. Land is much more plentiful, land cost is substantially lower, and environmental problems are not as pervasive. During the 1980s, Houston's inner city lost approximately 100,000 residents to the suburbs for some of these reasons. Businesses were closed and boarded up. Absentee landlords neglected their residential properties. One of the greatest losses was that dollars earned by the remaining residents did not stay in the neighborhood.

The only way that Houston's inner city can overcome such deterioration is to provide incentives that will make the city attractive to potential developers and business owners and allow the inner city to compete on a level playing field. Utilization of changes in the tax code may provide some of the incentives necessary to bring economic redevelopment back to urban areas like Houston. As a first step toward such revitalization, the City of Houston was designated a Federal Urban Enhanced Enterprise Community in December 1994. The Enhanced Enterprise Community (EEC) comprises an area of severe disinvestment, and is eligible to receive $25 million in social service and economic development initiative grant funds.

However, two major incentives are not available to Houston under current law -- wage tax credits and brownfields remediation deductions. The wage credit program is only available to those few communities that were designated as Empowerment Zones in 1994. Brownfields remediation deductions are part of a recent proposal that has not yet been enacted and, as such, are not currently available to potential business developers.

Need for Tax Incentives

New, sustainable job creation is an absolute necessity if the EEC is to improve and stay healthy. The ability to utilize wage tax credits as a tool to create these jobs would greatly enhance the City of Houston's ability to revitalize and stabilize these neighborhoods. New businesses or the expansion of existing businesses would mean that dollars would stay in the community. Jobs created with the assistance of the wage tax credit would mean that residents could now find employment in their neighborhood. Job transportation would become less of an issue and less of a cost, since residents would have no problem getting to a job in their own neighborhood. Wage tax credits would be an incentive for employers to hire youth, providing opportunities for disadvantaged residents that would otherwise not be available to them.

Furthermore, businesses would have a great incentive to expand within the EEC boundaries. Often, it is extremely difficult for new businesses or expanding entities to locate in marginal areas because initial cash flow is low. These credits would have a direct impact on net profits, which would enable businesses to take a chance on locating in an area that might not otherwise be possible.

Tax incentives could also help businesses overcome the environmental challenges to expansion. The City of Houston is extremely unique in that it is a city without zoning. Due to the historical lack of land use control measures, it is not surprising to find inner city neighborhoods surrounded by industrial properties. Many of these properties are now vacant and redevelopment is not occurring mainly due to the possibility of environmental problems.

Houston was recently awarded a brownfields grant, and the majority of the grant focus area is in or adjacent to the EEC. Yet adaptive reuse of the old industrial sites would be a much easier task if the potential private sector developer had the ability to write off environmental clean up costs quickly. The business would benefit both from the possible lower purchase cost and the developer's ability to recapture start up costs from wage tax credit savings.

Solutions: Making the Incentives Available

Earlier this year, President Clinton proposed an expansion of the EZ/EC program. Based on the Administration's plan, legislation has been introduced in both the House and the Senate to designate an additional 20 Empowerment Zones and 80 Enterprise Communities. S. 1911, introduced by Senators Moseley-Braun (D-IL), Jeffords (R-VT), and D'Amato (R-NY), and H. 3747, introduced by Representative Rangel (D-NY), embody the Administration's proposal to encourage economic redevelopment through utilization of tax code amendments. These bills would include new tax incentives to encourage brownfields clean-up. However, only two of the newly designated Empowerment Zones would be eligible to receive wage tax credits.

Rep. Foglietta (D-PA) has introduced a bill, H.R. 3241, that would allow an additional 9 areas to be designated as Empowerment Zones and receive the wage tax credit, along with other tax incentives for growth, including a credit for brownfields remediation costs. Other measures, including bills introduced by Senator Abraham (R-MI) and Senator Lieberman (D-CT), would expand the incentives available to distressed communities but would not specifically provide a wage tax credit or brownfields clean-up deduction/credit to businesses and developers.

We believe that the expansion of wage tax credits to more distressed communities and the adoption of brownfields clean-up incentives are crucial to the creation of jobs and the revitalization of deteriorated neighborhoods. We hope that you will support legislation to enact these important incentives so that the City of Houston and other inner cities can bring jobs and businesses back to the communities where they are so deeply needed. On behalf of the City of Houston, I thank the Subcommittee for the opportunity to testify on this issue that is so crucial to our nation's cities. Please do not hesitate to contact us if we can provide you with any additional information on this important matter.

Committee on Ways & Means
Subcommittee on Oversight

Hearing on the Impact of Taxation on Land Use

Tuesday, July 16, 1996, 11:00 a.m.
B-318 Rayburn House Office Building

Representative Charles B. Rangel of New York

Madame Chairman. Today the Committee sits to hear testimony of the impact of tax policy on land use. I thank you for allowing me to offer testimony in support of H.R. 3747, the Community Empowerment Act.

This legislation will expand upon the Empowerment Zone and Enterprise Community concept, which was passed as part of the Omnibus Budget Reconciliation Act of 1993. OBRA 93 authorized a Federal demonstration project of 9 Empowerment Zones and 95 Enterprise Communities that were designated through a competitive process. Among the benefits include tax incentives that: 1) offer an employment and training tax credit; 2) provide an additional $20,000 per year of Section 179 expensing; and 3) create a new category of tax-exempt private activity bonds.

H.R. 3747 also provides for tax incentives for the cleanup for as many as 30,000 brownfields, contaminated and polluted former industrial sites that lay abandoned and underutilized. Many of these areas are located in the distressed communities. Significant economic benefits can be realized if these sites are cleaned up and made available for use.

Under current law, cost incurred for new buildings or for permanent improvements made to increase the value of any property are not currently deductible, but must be capitalized. Under The Community Empowerment Act, certain remediation costs would be deductible if incurred while restoring a qualified site.

This incentive is expected to cost approximately $2 billion while leveraging $10 billion in private clean-ups nation-wide. With the possibility of returning as many as 30,000 brownfields to productive use and over 500 communities ready to participate, we must move forward with this responsible legislation.

H.R. 3747, The Community Empowerment Act is the next logical step to the Empowerment Zone initiative. Leveraging public sector resources to enable private-sector community investment is a fiscally responsible means of promoting community development and prosperity. I welcome my colleagues to join me in supporting this legislation.

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Statement of the Hon. Bill Thomas
HON. WILLIAM M. THOMAS
Subcommittee on Oversight
July 29, 1996

I appreciate this opportunity to comment on the ways in which federal taxes influence land use in the country. One million acres of farm land in the United States will be eaten up by parking lots, freeways, and suburban growth this year. In fact, within the hour, one acre of precious farm land in the Central Valley of California will be taken out of production. The Central Valley of California currently produces over $13 billion in agriculture produce and feeds millions in the U.S. and around the world.

This rural ground also provides vital habitat for thousands of animal species that range from kangaroo rats to white tailed deer. Farm land provides for a much better habitat for animals than a parking lot does. It is equally important that we provide incentives to people to keep their land in a natural state so that animal habitat can be preserved. Farm land in areas surrounding cities is being displaced by urban development at one of the fastest rates in history, and for this reason our farmers have been placed under new pressures.

When the great cities of our country were settled, they were developed near rich agricultural land to assure an adequate food supply. As urban areas continued to sprawl, many fertile acres were consumed and many more were placed at risk. Over the past ten years urban sprawl has eaten up over 26 million acres of productive farmland. In relative terms this equates to an area the size of the entire state of Kentucky displaced by urban development. Most of the farmland lost in the country has been located in urban-influenced counties where the density is at least 25 persons per square mile. A recent study by the American Farmland Trust estimated that the farm land in the urban-influenced counties was 2.7 times more productive than the remaining United States counties. 87% of our domestic fruit and nut production is also grown in these susceptible counties.

Farming is a capital intensive business and we can use that knowledge to design tax incentives to ensure farmland preservation. For example, farmers putting in a wine grape vineyard will encounter four year development costs of over $17,000 dollars per acre. Pistachio farmers should expect at least $7,000 dollars in preproductive costs per acre, and olive growers $5,000 dollars an acre. These costs could literally double or triple dependent on the value of the land.

Aside from the high start up costs of orchards and vineyards, U.S. farm real estate values also continue to rise. According to statistics compiled by the U.S. Department of Agriculture the value U.S. farm real estate has risen 6.4% over the past year to $832. This $832 figure may be rising, but it still does not nearly reflect the cost of acquiring a prime piece of farmland in highly productive, urban-influenced states like California and Florida. An average piece of farm land in California and Florida is worth over $2,000 and can be worth as much as $17,000.

Along with high costs, farmers are also plagued with storms, disease, and pests that destroy many acres of orchards and vineyards annually. Some of this costly acreage has not even reached a productive state. Crops like tangerines and cherries can take five to six years to reach productivity. In a natural disaster a farmer with a vineyard or an orchard still in its preproductive state may have trouble sustaining large losses because he has not even begun to receive a return on his investment.

After considering land use in California, I have developed two incentives that would amend the tax code and keep families in farming and land in rural uses.

I recently introduced H.R. 3749 to promote replacement of crops destroyed by casualty. This bill will provide an incentive to replant by allowing farmers to deduct the cost of replanting their destroyed crop in the event of freezing temperatures, disease, drought, or pests, all events that cannot be controlled. It also allows farmers to deduct the costs of replacing key infrastructure.

The need for this legislation is clear when one considers the way in which the farmers have to make decisions once a disaster strikes. Ordinarily, farmers have to capitalize the costs of planting a new orchard or vineyard. If a disaster strikes, they would still be forced to capitalize the costs of replacing essential infrastructure, trees and vines and other some other costs related to replanting. It will be years before those costs are deductible because of the long preproductive periods trees and vines may require. A farmer facing massive new investment requirements without deductions or income may decide to sell out. H.R. 3749 helps keep farmers on the land by allowing them to deduct more of the costs of replanting.

Estate taxes can also be extremely burdensome. According to the U.S. Department of Agriculture the average size farm in the U.S. is 469 acres. The land alone of an average California farm is worth over $1 million and can be worth as much as $8 million. Such farm values are the reason I introduced H.R. 520 to double the current maximum benefit under the estate tax special valuation deduction. A farmer can be worth millions in terms acreage, but it does not necessarily mean that his estate will have the money to pay estate taxes. Estate taxes can force family farm operations to be split into parcels and sold to developers just to cover taxes. H.R. 520's increased deduction of $1.5 million would allow for more continuity in farm acreage, making it easier to transfer land between generations and avoiding the need for families to split up their land to pay off the estate tax.

Prime agriculture land is being urbanized as we speak. Providing these small incentives to America's farmer would encourage families to provide a more natural habitat for our wild life as well as a secure and abundant food supply for the 21st century.

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