



44B

August 30, 1985

**COMMUNITY/CONVENTION CENTER**  
CITY OF SACRAMENTO

City Council  
Sacramento, California

CITY MANAGER'S OFFICE  
**RECEIVED**  
SEP 3 1985

Honorable Members in Session:

**SUBJECT: Report on Impact of President's Tax Proposal**  
**on Elimination of Certain Business Expense Deductions**

**APPROVED**  
BY THE CITY COUNCIL

SEP 10 1985

OFFICE OF THE  
CITY CLERK

SUMMARY

Besides the consequences on the City's financing programs addressed by separate report, other aspects of the President's Tax Proposal will also have negative impacts on the City.

The proposed Tax Reform Report as submitted by the Treasury Department would have a very serious economic impact on public assembly facilities. The International Association of Auditorium Managers, for which I am a District Vice President, strongly oppose the proposal eliminating business related entertainment deductions.

The economic impact certainly would be felt by the local arts--symphony, ballet, and opera--who have established sponsorship with local businesses and corporations for their related activities. This, too, would affect the sports tenants for the Community Center, the Arco Arena, Cal Expo, as well as events held in other community facilities.

As management of the Convention Center, there is a direct threat by this legislation in some of the other provisions that severely limit the amount of business related travel expenses that can be deducted. This translates into less attendance at trade shows, conventions, and business meetings held in the Complex.

It will also manifest itself in the loss of ancillary business income such as concessions stands, parking lots, souvenir shops, et al., as well as local employment in these areas.

The City Council should strongly oppose the elimination of business related entertainment deductions as proposed in the Tax Reform Report.



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BACKGROUND

The President's Tax Proposal totally eliminates business related entertainment deductions, including the cost of tickets and the cost of box suites, or other similar arrangements, that provide the taxpayer and his clients with a specific viewing area for sporting or entertainment events. This drastic proposal is not necessary because the law currently ensures that these expenses are only deductible when they go toward the furthering of legitimate business activity. Also, the economic effects on the sporting and other entertainment industries would be disastrous.

Currently, Section 162 of the Internal Revenue Code allows a deduction for all ordinary and necessary trade or business expenses. Ordinary and necessary expenses can include entertainment expenses, such as the cost of tickets or boxes from which to view events, but Section 274 severely restricts the deductibility of business/entertainment expenses. These expenses are not deductible unless they are "directly related to" or "associated with" the taxpayer's trade or business.

The costs of "entertainment facilities" such as yachts, hunting lodges or country clubs used to entertain clients are generally disallowed. The fact that the costs of tickets and box suites are not currently considered "entertainment facilities" is a recognition that these expenses are legitimate business deductions if they otherwise meet the strict standards of Section 274. By seeking to totally eliminate legitimate business deductions, the Treasury Department's proposal is too broad because the law currently ensures that abusive practices are minimized. The Treasury Department argues that entertainment expenses such as the cost of tickets and box suites are mostly personal, therefore taking business deductions for them cannot be justified. Even though business may not be carried on during the event itself, it is well known that entertainment expenses incurred by businesses, for the benefit of their clients, fosters later business discussions, promotes good will and generally increases the likelihood of profitable transactions.

The elimination of the entertainment deduction for tickets and box suites will cause severe economic hardship to the public assembly facility operators and owners. It is estimated that businesses purchase approximately one-third to one-half of all tickets sold for most sporting and theater events. Box suites are almost entirely supported by business purchasers. The elimination of the entertainment expense deduction will substantially decrease revenues received by the operators and owners of stadia, arenas, performing arts centers and other places of public assembly because, without the deduction, businesses are likely to reallocate their marketing dollars into activities where expenses are still tax deductible.

Not only will the operators and owners themselves suffer from lost revenues due to decreased attendance, the ancillary businesses such as parking lots, concession stands and souvenir shops will also suffer a decline in their revenues. Consequently, these service industries connected with public assembly facilities will be forced to lay off workers, most of whom are the very ordinary citizens the Treasury Department is purporting to help. Additionally, a reduction in attendance will decrease the value of advertising

space in the facilities and income normally derived from it. Also, a reduction in attendance will decrease the economic impact the public assembly center has on the community where it is located. The taxes normally generated by sporting and other public events will also be adversely affected. The economic losses will have to be made up through higher ticket prices which inevitably will be passed on to the average fan and the taxpayer that, in most cases, funds any operating deficits.

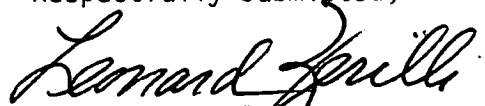
Another provision of the report deals with the deductibility of business expenses incurred for travel to educational meetings. While the language contained in the report is somewhat vague and unclear, if the intent of the proposal is to disallow such business deductions that are currently allowable for attending educational meetings and trade shows, the effect on municipally supported convention and exposition centers would be severe. Once again, the ripple effect would be the same as described above for stadiums and other public facilities -- those taxpayers least able to accept the economic impact would be the most affected. Already disallowed by law are deductions for such questionable activities as conventions, seminars, or other meetings held aboard cruise ships. If, in fact, deductions for expenses incurred to attend meetings and trade shows whose purposes are clearly to educate, are to be then disallowed, the City Council should strongly oppose such proposed legislation.

RECOMMENDATION

It is our recommendation that the Sacramento City Council adopt the attached Resolution stating opposition to the provisions of the President's Tax Proposal which would eliminate entertainment and business deductions that are currently controlled under I.R.S. regulations or provide educational opportunities to participants.

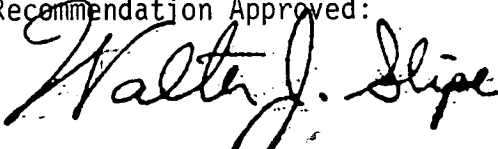
It is also recommended that copies of this Resolution shall be mailed to the President, and the Vice President, Treasury Secretary James Baker, Assistant Treasury Secretary for Tax Policy Ronald Pearlman, and the Senators and Congressmen representing the State of California, with the request that they not support any tax reform proposal that includes any of the foregoing restrictions.

Respectfully submitted,



Leonard Zerilli, C.F.E.  
Assistant Director, Community Center  
Vice President, District VII,  
International Association of Auditorium  
Managers

Recommendation Approved:



Walter J. Slipe City Manager

44B

# RESOLUTION NO. 85-703

ADOPTED BY THE SACRAMENTO CITY COUNCIL ON DATE OF

APPROVED  
BY THE CITY COUNCIL

1955

OFFICE OF THE  
CITY CLERK

RESOLUTION OPPOSING THE PROPOSAL THAT  
WOULD TOTALLY ELIMINATE BUSINESS RELATED  
ENTERTAINMENT DEDUCTIONS AND THE DEDUCTIBILITY  
OF BUSINESS EXPENSES INCURRED FOR TRAVEL TO  
EDUCATIONAL MEETINGS

BE IT RESOLVED BY THE COUNCIL OF THE CITY OF SACRAMENTO:

Opposes the elimination of certain provisions of the President's Tax ,  
Proposal, namely:

- (1) Business related entertainment deductions, including the cost of tickets or other similar arrangements, that provide the taxpayer and his client with a specific viewing area for sporting and entertainment events.
- (2) The deductibility of business expenses incurred for travel to educational meetings.

The Treasury Department's proposals are not necessary under the current law and will have disastrous consequences for both public assembly facilities and related industries involved and the ordinary taxpayers the Treasury purports to help.

\_\_\_\_\_  
MAYOR

ATTEST:

\_\_\_\_\_  
CITY CLERK



## CITY OF SACRAMENTO

ANNE RUDIN

Mayor

City Hall  
915 I Street, Room 205  
Sacramento, California 95814  
(916) 449-5407

September 10, 1985

The Honorable Robert T. Matsui  
231 - Cannon Building  
Washington, D.C. 20515

SUBJECT: City of Sacramento Concerns with President's Tax Proposal

Dear Congressman Matsui:

Transmitted herewith are staff and community analyses as well as City Council Resolutions which voice our concerns to a number of aspects of the President's tax proposal. Obviously, we in Sacramento are concerned with the financial health of the United States economy and are not in any manner opposed to tax reform as a goal.

However, the President's tax proposal in its present form raises serious financial problems for our local economy; we are sure similar problems would occur for all local governments in the United States. Hopefully, in your upcoming deliberations on the President's tax proposal and in developing the solutions that provide tax reform and improve the financial health of the United States economy you will give consideration to the following areas which we believe are extremely important:

- The President's tax proposal severely curtails and/or greatly increases the cost of municipal financing and has serious financial impacts on Sacramento. Projects such as our Community Center expansion, parking garages, solid waste processing facilities, etc. may not be able to be financed at all. Further, the requirement to spend bond proceeds within 30 days is not prudently feasible. Finally, these proposed changes appear to be inconsistent with the President's position of cooperation between the public and private sectors and,
- The loss of state and local tax deductions for federal income tax purposes makes support of local programs more expensive for the taxpayer at a time when City and County budgets are being reduced and,

- The proposed elimination of regulated business deductions for education and entertainment will impact the local economy as well as the arts and other local events and may result in the inability to provide these services and events to our local public, and,
- Proposed changes in the "at risk" rules, depreciation schedules, Mortgage Revenue Bonds and Builder Bonds for real estate transactions will discourage private investment in these ventures and result in increased costs for home, apartment or business rentals and reduced employment in building and related industries.

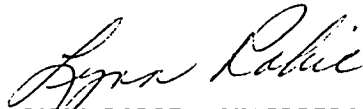
We well understand the serious financial challenges facing the United States Economy. However, in its present form, we do not believe the President's tax proposal deals with these problems in an effective manner.

Please feel free to call should you have any questions.

Sincerely,



ANNE RUDIN, MAYOR  
City of Sacramento



LYNN ROBIE, CHAIRPERSON  
Budget & Finance Committee

TPF:naw:ptpcrns

Attachments

cc: David Miller,  
District Representative

# RESOLUTION NO. 85-702

ADOPTED BY THE SACRAMENTO CITY COUNCIL ON DATE OF  
SEP 10 1985

## RESOLUTION PROTESTING FURTHER RESTRICTIONS ON, OR ELIMINATION OF, TAX EXEMPT BONDS BY THE FEDERAL GOVERNMENT IN ITS CONSIDERATION OF FEDERAL TAX REFORM AND SIMPLIFICATION PROPOSALS

WHEREAS, the balance of power between the Federal Government and the States is embodied in the Tenth Amendment to the U.S. Constitution, which explicitly states that "the powers not delegated to the United States are reserved to the States";

WHEREAS, the Constitution reserves to the states all those powers which in the ordinary course of affairs, concern the lives, liberties and properties of the people and the internal order, improvement and prosperity of the state, while granting to the federal government only certain specific powers which were designed to accomplish objects of purely national concern;

WHEREAS, the emergence of the United States as a complex industrial society has caused a dramatic increase in the number of legitimate local responsibilities and concerns, and state and local governments have been forced to assume a variety of additional sovereign functions in order to protect and further the public welfare, causing an increase in the capital and operating requirements of such state and local governments;

WHEREAS, state and local governments have sought to alleviate the burden on their capital and operating budgets by enlisting the aid and cooperation of the private sector to develop and construct necessary public projects and by financing such projects through the issuance of bonds, the interest on which is properly exempt from federal taxation since such obligations assist state and local governments in the performance of their sovereign functions;

WHEREAS, in 1982 and 1984, Congress severely limited the ability of state and local governments to finance the development and construction of necessary public projects when it passed the Tax Equity and Fiscal Responsibility Act of 1982 and the Deficit Reduction Act of 1984, which, inter alia, limited the "public purposes" for which such bonds could be issued and imposed a volume limit on the amount of such bonds per state;

WHEREAS, Congress is presently considering proposals for reform and simplification of the federal tax system, which call for the elimination of most tax exempt bonds and impose several unwarranted restrictions on the ability of state and

local governments to issue tax exempt bonds for those limited purposes deemed permissible by the federal government without regard to the states' sovereign powers;

WHEREAS, the federal government, in attempting to justify its proposals for tax reform, has alleged that tax exempt bonds are tools used by rich people and corporate America to increase their wealth at the expense of the national treasury, while in fact tax exemption benefits all citizens whose general welfare state and local governments are charged to provide;

WHEREAS, further restriction of tax exempt bonds by the federal government compromises the ability of state and local governments to determine the manner in which they will meet their capital needs and respond to changing local circumstances, impairs their ability to perform their sovereign functions, and upsets the balance of power between the states and the federal government as set forth in the Constitution;

WHEREAS, California state and local government lead the nation in the use of tax exempt financing with \$15 billion in 1984.

NOW, THEREFORE, BE IT RESOLVED AS FOLLOWS:

1. The City Council, City of Sacramento hereby protests any further restrictions on tax exempt bonds by the federal government.
2. State and local governments must be allowed to issue tax exempt bonds for all facilities which serve the general public without regard to whether private persons assist in providing such facilities through ownership or operation of such facilities. These public facilities include sewer systems, solid waste disposal systems, airport, dock and wharf facilities, public power facilities, parking facilities, low income housing facilities and health care facilities. Privatization of such facilities represents a partnership between state and local government and private industry to deliver needed services to the public at the lowest possible cost.
3. Such proposed tax reform measures as elimination of arbitrage, prohibition of advance refundings, mandated reporting to the federal government of tax exempt bond issues and restrictions on the deductibility of interest by financial institutions which invest in municipal bonds constitute imper-



missible intrusion on the right of state and local government to carry out public projects for the general welfare of their citizens and must not be adopted by Congress.

4. The so-called 1% Rule which has been proposed to define what constitutes valid governmental purpose is not acceptable in that it would cause many traditional public purpose projects to be deemed taxable rather than tax exempt.

5. Copies of this Resolution shall be mailed to the President, and the Vice-President, Treasury Secretary James Baker, Assistant Treasury Secretary for Tax Policy Ronald Pearlman and the Senators and Congressmen representing the State of California with the request that they not support any tax reform proposal that includes any of the foregoing restrictions on the right of state and local governments to issue tax exempt bonds for public purposes.

ANNE RUDIN  
MAYOR

ATTEST:

LORRAINE MAGANA  
CITY CLERK

CERTIFIED AS TRUE COPY  
of Resolution No. 85-702

SEP 11 1985

DATE CERTIFIED

Deputy

CITY CLERK, CITY OF SACRAMENTO

# RESOLUTION NO. 85-703

ADOPTED BY THE SACRAMENTO CITY COUNCIL ON DATE OF

SEP 10 1985

RESOLUTION OPPOSING THE PROPOSAL THAT  
WOULD TOTALLY ELIMINATE BUSINESS RELATED  
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sporting and entertainment events.
- (2) The deductibility of business expenses incurred for travel to  
educational meetings.

The Treasury Department's proposals are not necessary under the current  
law and will have disastrous consequences for both public assembly facilities  
and related industries involved and the ordinary taxpayers the Treasury purports  
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ANNE RUDIN

MAYOR

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LORRAINE MAGANA

CITY CLERK

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DATE CERTIFIED  
*Lorraine Magana*  
CITY CLERK, CITY OF SACRAMENTO



CITY OF SACRAMENTO

CITY MANAGER'S OFFICE  
**RECEIVED**

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AUG 26 1985

OFFICE OF THE TREASURER  
800 . 10TH STREET SACRAMENTO, CA 95814  
SUITE 1 TELEPHONE (916) 449.5318

THOMAS P. FRIERY  
TREASURER  
DONALD E. SPERLING  
ASST. TREASURER

August 23, 1985

Sacramento City Council  
Sacramento, California 95814

SUBJECT: President's Tax Proposal Impacts on City of Sacramento Financing Programs

APPROVED

SEP 10 1985

OFFICE OF THE CITY CLERK

SUMMARY

If implemented in its present form, the President's Tax Proposal would have devastating negative consequences on the City's capital financing programs as well as those programs for other municipal governments in the United States. Very briefly, two of the major impacts will be the elimination of any City of Sacramento/private sector partnership approach to any project where the private sector would use 1% or more of the facilities or where a lease for more than 1 year was entered into with the private sector.

Further, with the proposal requiring that a significant percentage of municipal revenue bond proceeds being expended within 30 days of bond settlement, it would be necessary for the City to internally fund a significant portion of capital projects prior to selling bonds.

The President's Tax Proposal, as it impacts the tax-exempt financing capability of local government, should be vigorously opposed. It is recommended the City Council adopt the attached Resolution which addresses this issue.

THE PRESIDENT'S TAX PROPOSAL  
AND EFFECT  
ON CITY OF SACRAMENTO FINANCING PROGRAMS

The current tax law reform proposals of the President if enacted will dramatically curtail and/or prohibitively increase the cost of providing municipal services. The proposal effectively eliminates public-private partnership in building and providing City services which has previously been recommended by the President and pre-empt the City from using traditional financing tools.

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Sacramento City Council  
August 23, 1985  
Page 2

A review of the City's 5 year capital improvements program reveals that numerous projects may not qualify for tax exempt status should the President's proposal be implemented. Some of these projects by category are:

- Sewage and Solid Waste Disposal
- Water Supply Facilities
- Convention and Trade Show Facilities
- Administrative Offices
- Libraries (Public-Private Partnership)

Other projects which are not directly the financial responsibility of the City at this time but are of interest to the City are:

- Airport, Docks and Wharves Facilities
- Mass Community Facilities
- Sports Arena

The following represents my concerns with the President's proposed tax plan:

- 1) In providing facilities such as convention facilities, administrative offices, mass community facilities, etc., it is common practice to have eating facilities, shopping areas, etc. for workers or the public using the facilities. The City does not compete or operate eating facilities or sales of convenience items; rather, these matters are contracted for in the private sector. Further, in projects such as mass community facilities, it should be considered these small shopping areas offer security to the public users of the project. Finally, it is possible to have the private sector construct a library facility or other project if a portion of that facility is made available for commercial as well as public use. This approach results in land and property coming back onto tax rolls and the private sector providing the capital to build the needed facility.

The President's tax proposal states that if 1% or more of the facility and/or a lease for more than 1 year is signed with the private sector to provide these services, then the tax exemption on municipal bonds is lost. Further, proposed changes in the depreciation schedule to the private sector would severely reduce benefits to the private sector for building and owning a facility and possibly reduce their interest in assisting the public sector's capital needs.

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- 2) The City, like all other municipal government, experiences cash flow operating problems since major revenue sources (property taxes) are received in April and December of each year, whereas operating costs or expenses are uniform throughout the year. To deal with this problem, the City issues Tax and Revenue Anticipation Notes to raise cash to avoid the cash flow problems. The difference between the City's borrowing costs and any money it earns during the course of the year on the monies borrowed (arbitrage) is used to offset the costs of financing the issue. Any additional monies earned over the financing costs and expenses are deposited in the General Fund to offset the cost of City services to the public.

For the City to pay the Federal government all arbitrage earnings would severely increase the cost of municipal government. Further, present arbitrage laws and practices are adequate to assure no abuses occur in meeting cash flow needs.

A second concern in this area is the President's proposal to use bond proceeds to immediately call previously issued bonds. No consideration was given to the fact that legally, many previously issued municipal bonds cannot be called for 5 to 10 years or longer. Advance refunding permits a City to reduce its obligation under previously issued higher cost bond issues with lower cost money today. This activity substantially reduces the cost of government.

Effectively, the President's proposal prohibits use of advance refunding bond issues by local government.

- 3) The President's proposal requires that a "significant percentage" of bond proceeds be spent within one month of receiving and all proceeds be spent within 3 years. It would not be possible for the City of Sacramento to pay builders or contractors with City monies until they have completed a significant portion of a project before we sold bonds. Further, this approach would eliminate the opportunity to time the sale of a bond issue to assure the lowest possible interest cost was received.

Current law provides that unless 85% of bond proceeds are expended within 3 years, the bond becomes taxable. This law and financing practices assures monies are not raised prior to the prudent determination of their need.

- 4) The President's Tax Proposal would eliminate the deductibility for carrying costs for the banking systems purchases of municipal bonds. If this proposal is enacted, underwriting of municipal issues by banks would be more costly.

44A

Sacramento City Council  
August 23, 1985  
Page 4

- 5) Any City bond issue that could be marketed would be subject to Industrial Development Bond reporting requirements and may require pre-approval of the Department of Treasury and/or the Internal Revenue Service.

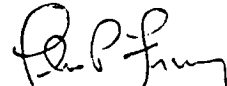
Other provisions in the President's tax proposal such as minimum tax could also have impact on purchasers of municipal bonds. We believe municipal bond interest earnings should be exempt from any minimum tax considerations.

The President's tax proposal will be devastating to the City of Sacramento and other municipal issuers. Effectively, it will eliminate a municipality's tax-free borrowing authority and severely increase the cost of government services at a time when it appears the Federal government is shifting major costs to local government.

RECOMMENDATION

The Sacramento City Council adopt the attached Resolution which protests further restrictions or elimination of municipal tax-exempt financing by the Federal Government.


Respectfully submitted,

  
 THOMAS P. FRIERY  
 City Treasurer

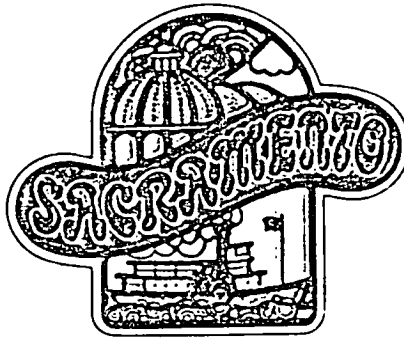
TPF/lv

Attachment

RECOMMENDATION APPROVED:

  
 WALTER J. SLUPE, City Manager

September 10, 1985  
All Districts



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August 30, 1985

COMMUNITY/CONVENTION CENTER  
CITY OF SACRAMENTO

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Sacramento, California

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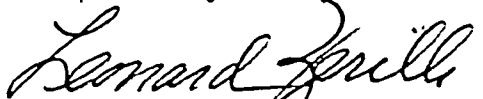
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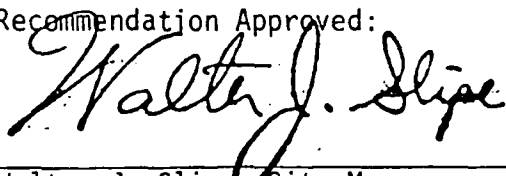
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Respectfully submitted,



Leonard Zerilli, C.F.E.  
Assistant Director, Community Center  
Vice President, District VII,  
International Association of Auditorium  
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Recommendation Approved:



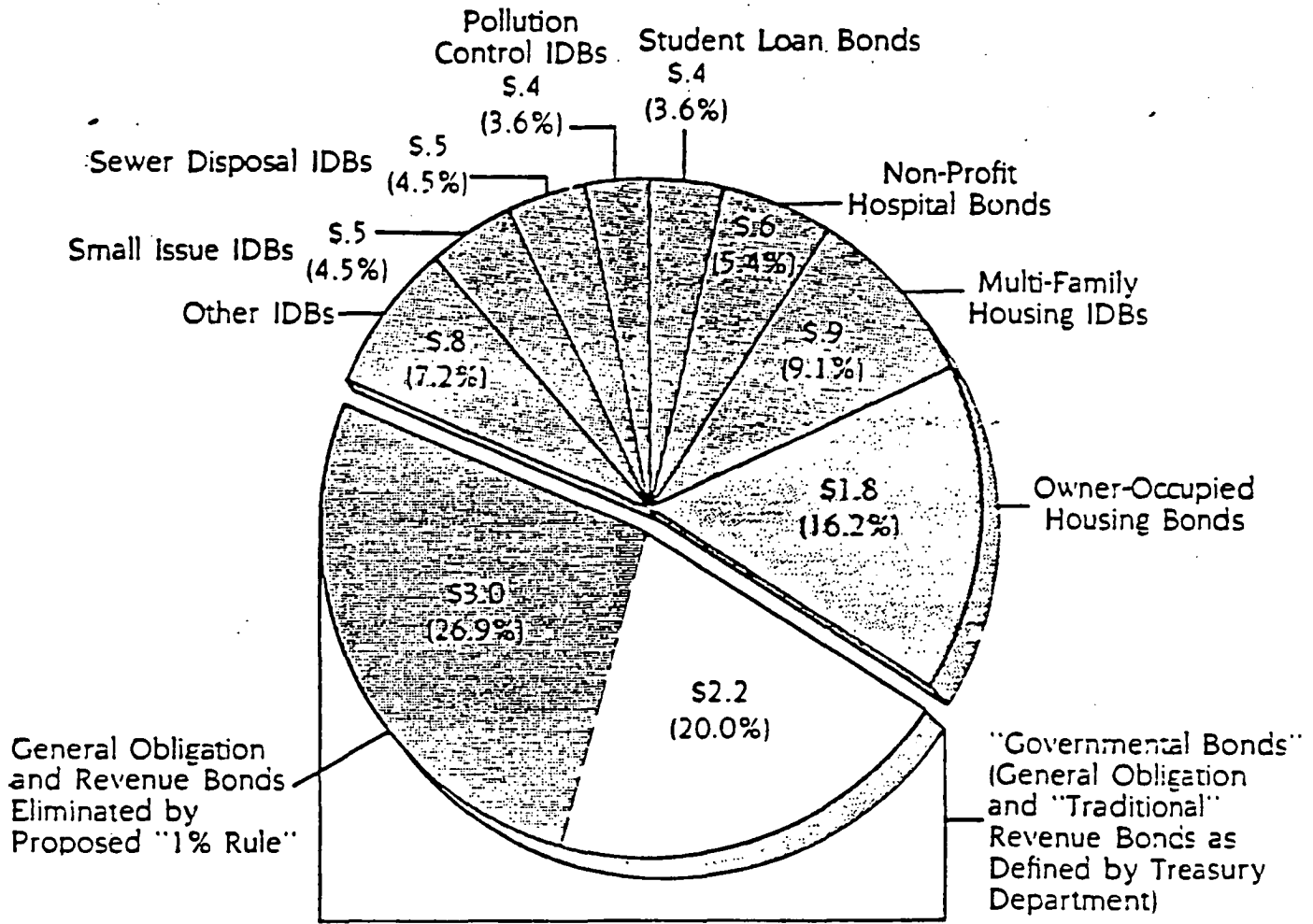
Walter J. Slipe City Manager

7-10-85  
#44

# CALIFORNIA Municipal Bonds Denied Tax-Exempt Status Under Treasury Proposal

(\$ in Billions)

1984 Long-Term Bonds Denied Tax-Exempt Status



Total Issued: \$11.1

Total Denied Tax-Exempt Status: \$8.9

Source: Estimated Effect of "1% Rule" — Public Securities Association.  
All Other Volume Figures. U.S. Treasury Department.

## Wipeout of Bonds

# League of Cities Attacks Tax Plan

Washington

President Reagan's tax overhaul proposal would severely restrict the ability of cities to finance many projects with tax-exempt bonds, the National League of Cities said yesterday.

The proposed elimination of federal tax exemptions for industrial revenue bonds "could all but wipe out any new construction" for low-income housing, Alan Beals, the league's executive director, said in releasing a study of Reagan's tax package.

The administration's proposal would eliminate the tax exemptions for revenue bonds used to finance projects that have more than a 1 percent non-government use.

The rule would wipe out at least 60 percent of the tax-exempt revenue bonds that cities float to finance low-income housing, economic development projects, airports or sewage treatment plants, Beals said.

John E. Petersen, director of the Government Finance Research Center, who helped compile the league's study, estimated that the

rule would eliminate \$60 billion to \$80 billion worth of tax-exempt bonds each year.

The president's plan also would restrict cities' access to short-term bonds underwritten by commercial banks, which can now write off 80 percent of the interest charges, he said. Banks would lose this tax incentive under the plan.

The elimination of the deduction for state and local taxes would increase political pressure on cities to lessen the tax burden on high-income residents by cutting services or charging user fees, which will hurt low-income city dwellers, the report said.

The end of the deduction demise could hurt property values, undermining a city's tax base and, consequently, its credit rating, Petersen said.

Between 1979 and 1984, federal housing aid declined 55 percent, from \$30.3 billion to \$13.5 billion, according to league figures. During the same period, tax preferences in the form of revenue bonds, tax credits and other incentives increased 152 percent, from \$28.3 billion to \$71.3 billion.

Associated Press

SAN FRANCISCO CHRONICLE 9/6/85

Note:

An identical letter was sent to all Ways and Means and Senate Finance Committee members.

June 21, 1985

The Honorable Daniel Rostenkowski, III  
2111 Rayburn House Office Building  
Washington, D.C. 20515

Dear Representative Rostenkowski:

The undersigned groups representing state and local government have reviewed the provisions in "The President's Tax Proposal to the Congress for Fairness, Growth and Simplicity" affecting tax-exempt bonds and find the proposal unacceptable. We are deeply concerned that the present plan will curtail the use of tax-exempt financing for well accepted public purposes and in many instances even make state and local general obligation and revenue bonds taxable. It has been estimated that between 62 to 80 percent of all municipal bonds will lose their tax-exempt status. This joint statement is evidence of the high level of dissatisfaction with the bond provisions in the Administration's plan.

Specifically, we are opposed to:

- o The distinction between "governmental" and "nongovernmental" purposes. The proposal to deny tax exemption if (1) more than one-percent of the municipal bond proceeds are used directly or indirectly for nongovernmental purposes and (2) if the facilities are not available on the same basis for all members of the general public presents substantial difficulties. Many general obligation bond programs may be affected because of the one-percent rule. Tax-exempt revenue bond financing for many other state and local government functions -- such as water systems, sewers, mass transit, airport and port facilities -- will be precluded or made more difficult.
- o The modification in the corporate minimum tax that further reduces the deduction taken by banks and other financial institutions for the costs incurred in buying and carrying tax-exempt obligations. In recent years, the market for municipal bonds has been supported by individual investors whose marginal tax rates rose with increases in income because of high inflation. At the same time, the demand for municipal bonds by banks and other financial institutions decreased dramatically because of the reduced profitability of these institutions, the expansion of competing ways to reduce taxable income, and previous tax law changes affecting the deduction taken by these institutions in connection with municipal obligations. Historically, these institutions were major purchasers of our obligations.
- o The imposition of further restrictions on arbitrage unless there are clearly identified problems and targeted solutions. The investment of bond proceeds at market rates for a reasonable period of time pending their application for the purposes of the bond issue is good cash management. Arbitrage, which is the term used to describe the interest earned on invested bond proceeds in excess of the interest being paid on the bonds, reduces the cost of public projects by reducing the total amount of bonds issued for a project. State and local governments should not be penalized for practicing good financial management by being required to "rebate" such investment earnings

Contact Persons on Tax-Exempt Bonds

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Authorities

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Washington, D.C. 20004  
626-3020

United States Conference of  
Mayors

Joan Bannon  
1620 Eye Street, N.W., 4th Floor  
Washington, D.C. 20006  
293-7330

to the U.S. Treasury or by the imposition of other unnecessary restrictions.

- o The extension of certain requirements in current law to all municipal bonds. The Treasury proposal will extend requirements that were enacted to restrict other tax-exempt borrowings, such as the IDB reporting requirements, to all tax-exempt bonds. These requirements will impose greatly increased administrative burdens on states and local governments and increase their costs.
- o The prohibition of all advance refundings unless there are clearly identified problems and targeted solutions. The prohibition of all advance refundings fails to distinguish legitimate and justified advance refundings from those that are abusive. Where interest cost savings of a significant magnitude can be realized and where the elimination of burdensome restrictions, relief of financial distress or rearrangement of debt service is warranted, the ability to advance refund bonds is desirable. States and localities should have the same opportunities to restructure their debt as is available to private corporations.
- o The restrictions on public/private partnerships. The Treasury proposal, if adopted, will seriously restrict the ability of states and local governments to continue to finance facilities on a public/private partnership basis. For example, it would impair the present financing and construction arrangements for such facilities as solid waste disposal.

The signatories are convinced that the proposal, if adopted, will mean a reduction in state and local government services or a greater tax burden on our citizens. We are therefore united in our opposition to the bond provisions contained in the Administration's tax reform proposal.

Sincerely,

Airport Operators Council,  
International, Inc.

American Public Power  
Association

International City Management  
Association

National Association of State  
Budget Officers

National Governors' Association

United States Conference of  
Mayors

enclosure

American Association of Port  
Authorities

Government Finance Officers  
Association

National Association of Counties

National Conference of State  
Legislatures

National League of Cities

AN ANALYSIS OF TREASURY ESTIMATES  
OF REVENUE GAINS FROM THE PROPOSED  
ELIMINATION OF SELECTED TAX-EXEMPT  
SECURITIES

COOPERS & LYBRAND  
JULY 1985

## EXECUTIVE SUMMARY

The President's tax reform proposal contains a provision that certain financing with state and local bonds would no longer be tax-exempt. These bonds are currently used to finance many diverse activities, including airport and port facilities, hospitals, pollution control, roads and bridges, water and sewer facilities, public housing, industrial development projects, elementary and secondary education, and student loans.

According to the tax reform proposal, which refers to these bonds as "nongovernmental bonds," the primary effects of these bonds are "...lowering tax receipts and forcing increases in the tax rates on non-exempt income."

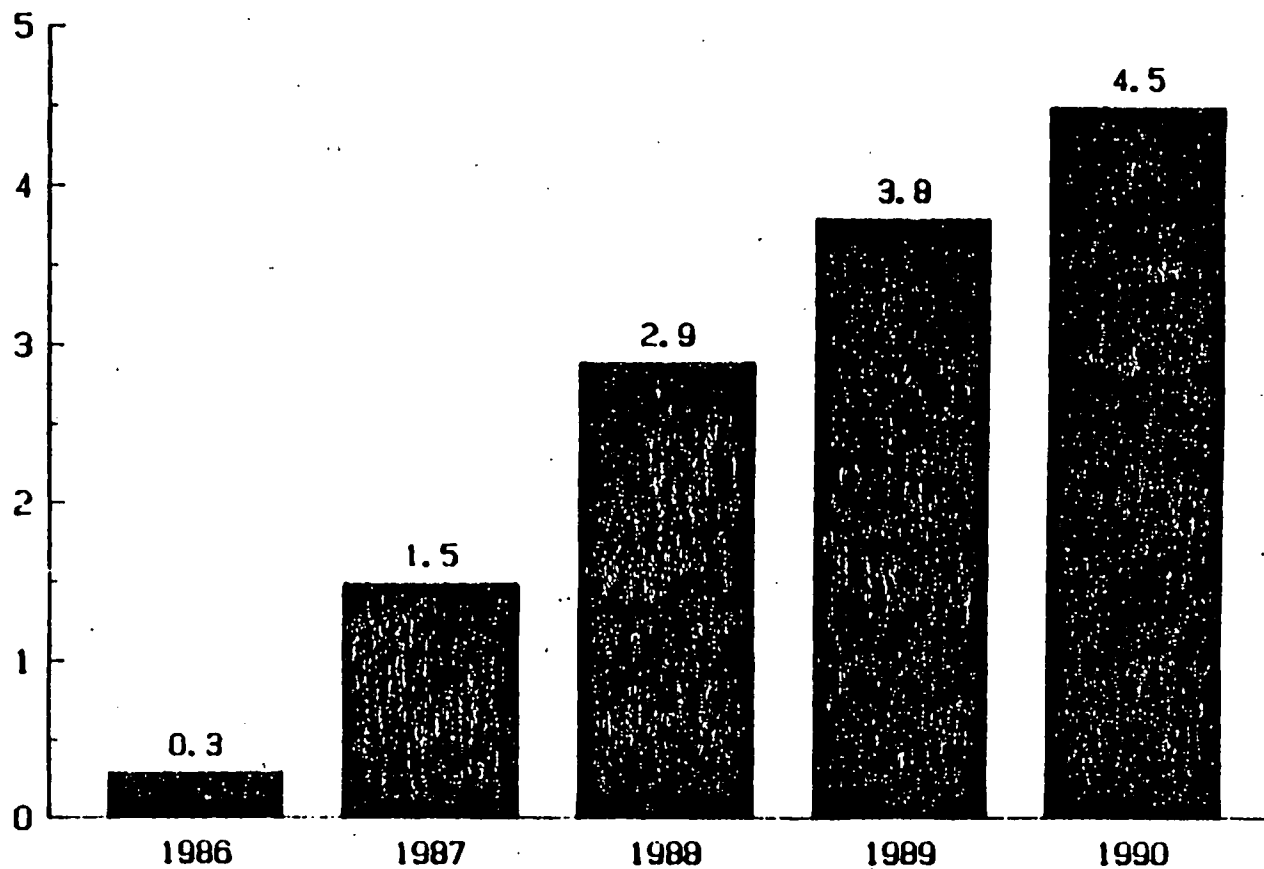
In the President's tax reform proposal, the revenue gains from the repeal of the current exemption for selected tax-exempt bonds are estimated by the U.S. Treasury to be \$300 million in fiscal year 1986, growing to \$4.5 billion in fiscal year 1990 (see chart on following page). For the five-year period 1986 to 1990, the Treasury-forecasted accumulated revenue gain amounts to \$13 billion if the exemption for these bonds is repealed. The results of our study indicate that the Treasury approach is inappropriate and incomplete and that the anticipated revenue gains from the elimination of these tax-exempt bonds would be much less--amounting to a total of less than \$2 billion over the 5 year period. This represents a revenue gain estimate that is 85% less than the Treasury estimate.

The significance of these Treasury estimates should not be understated since they are a principal and stated rationale for repealing the exemption. So it is critical, from a public



# Treasury Estimates Of Revenue Gains From Elimination Of Tax-Exempt Bonds

\$ billions



policy point of view, that the basis of the estimates be well-known, the assumptions be visible, and the soundness of the estimates be judged and that they become part of the public policy debate.

#### A MAJOR ISSUE AND RESULTS OF C&L STUDY

The Treasury has raised an issue concerning these tax-exempt bonds, referring to them as a source of the "serious erosion in the Federal income tax base." An implication of eliminating these selected tax-exempt bonds is the revenue gain to the Treasury. The issue of the likely revenue gain to the Treasury and the methodology used by the Treasury to estimate the gains were the main concerns of our study.

In the performance of this study, it was necessary to develop our own replication of the Treasury estimate of the revenue gains from the elimination of certain tax-exempt bonds. We were not provided with sufficiently detailed information concerning the Treasury assumptions and numbers to discern the exact Treasury methodology. So, as a starting point for our analysis, we create an approximation of the revenue gain results of the Treasury. The specific steps of this replication are detailed in the text.

Since the Treasury estimation approach left out several critical elements, we included a number of key factors in our estimation of the revenue gains. Our analysis and modeling efforts yielded results markedly lower than the Treasury estimates for the period from 1986 to 1990. These results indicate that the anticipated revenues to the federal government from the elimination of selected tax-exempt bonds are 80% to 95% lower than the Treasury's own estimates.

In other words, the revenue gain to be expected from this provision of the President's proposal is likely to yield an accumulated total of less than \$2 billion over the next five years, rather than the \$13 billion estimated by the Treasury (see chart on following page). Our estimates do not include several other likely effects of the President's proposal that could lower the revenue estimate even further. Nor do they include the increased costs to be borne by state and local governments from the elimination of selected tax-exempt bonds.

#### C&L EVALUATION OF TREASURY METHODOLOGY

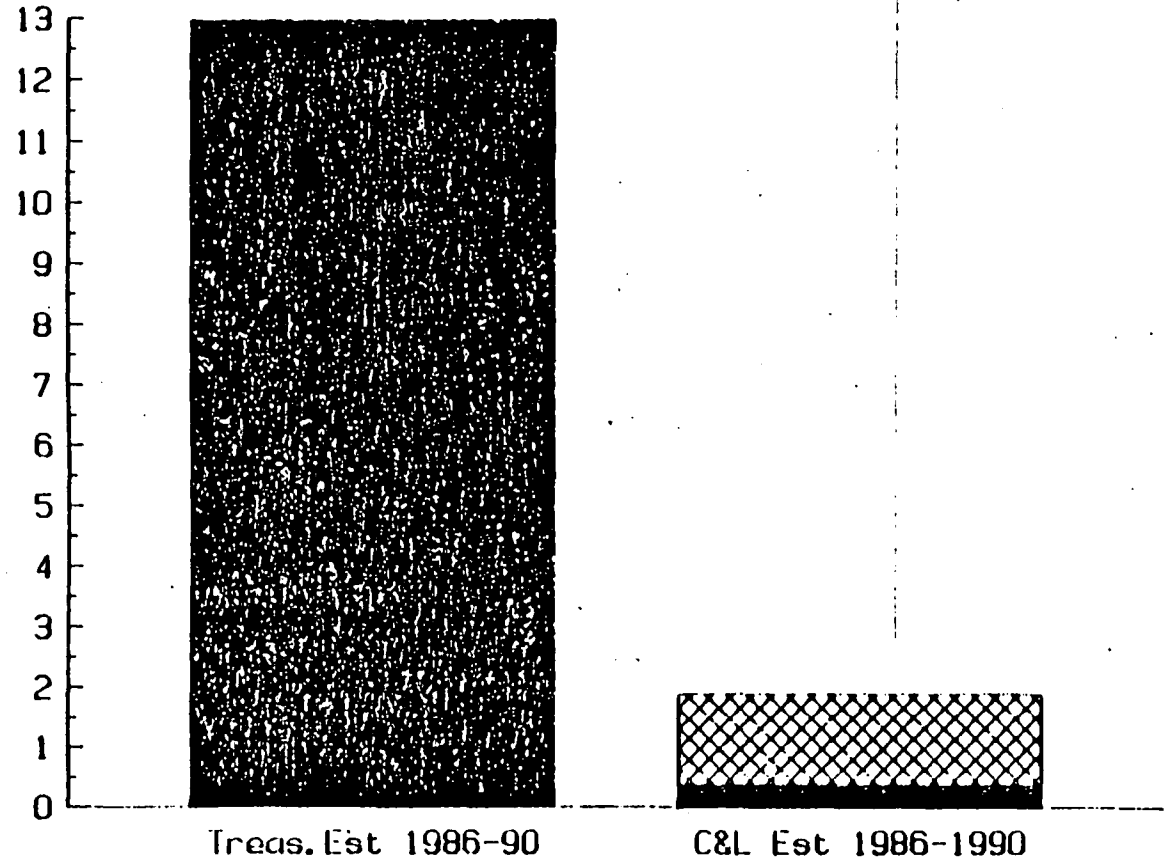
The Public Securities Association asked Coopers & Lybrand to perform an independent review of this issue of the alleged gain of federal revenues from the repeal of selected tax-exempt bonds. As part of this review, we address the major issues that have surfaced about the status of tax-exempt securities, identify the critical issues that surround the Treasury estimates of gains from the repeal of certain tax-exempt bonds, replicate the Treasury estimates, and develop an independent estimate of the federal revenue gains.


During the course of its review, Coopers & Lybrand performed the following:

- . A survey of the available and relevant literature on the subject of tax-exempt bonds, and on the bonds proposed for elimination;
- . A review and assessment of Treasury estimates of the revenue gains from the repeal of the tax exemption of these bonds;
- . Interviews of government officials on the Treasury methodology for estimating revenue gains and the changes in that methodology in recent years.

# Treasury and C&L Accumulative Revenue Gains Estimate

\$ billions



 Range of Estimate

MAJOR LIMITATIONS OF THE TREASURY METHODOLOGY

The Treasury has developed a methodology to calculate the estimated revenue gains from the elimination of the selected state and local tax-exempt bonds. Our review of the Treasury's approach identified several major assumptions in its methodology that run counter to what would be expected:

- . The entire volume of eliminated tax-exempt bonds would be issued as fully taxable bonds;
- . Capital markets are not efficient;
- . There are no real market effects from the elimination of the tax-exempt bonds; that is, omitting the economic impact effects of the proposed repeal;
- . Use of current marginal tax rates to evaluate the effect of the President's proposal on revenue gains to the Treasury.

We have examined the Treasury's methodology and concluded that the calculation of the estimated revenue gains from the elimination of the tax-exemption for selected municipal bonds is incomplete and lacks a convincing underlying model of the workings of capital markets.

The Coopers & Lybrand estimate of revenue gains took into account alternative volume estimates, a small diversion of investment funds, and a more realistic portfolio adjustment. Whereas the Treasury assumes that 100% of the funds from the eliminated bonds would be allocated to fully taxable bonds, we have allocated the funds on a 40%-40%-20% basis. That is, 40% of

the funds are used to acquire fully taxable assets, 40% to acquire other lower-taxed assets such as equities, and the final 20% going to the remaining tax-exempt market.

These adjustments led to a revenue gain estimate of \$4.2 billion for the five-year period, and amount to a 67% reduction from the Treasury estimate.

Our analysis also included an estimate of the indirect economic impact (or spillover) of this provision and its impact on economic activity. There is also a corresponding change in federal revenues which are directly influenced by changes in economic activity. This was estimated by using Coopers & Lybrand's neoclassical model of the U.S. economy to simulate the impact of the proposed tax change. The result of this simulation showed a revenue gain of \$9.4 billion for the period, a reduction of 27% from the Treasury estimate.

When combined, the Coopers & Lybrand estimate of volumes, diversion of funds, variable allocation, and spillovers or indirect economic impact yields a revenue estimate of \$2 billion or a reduction of 85%. Our sensitivity analysis for key elements of the model yields estimates 80-95% below the Treasury's.

#### OTHER FACTORS COULD ALSO INFLUENCE THE RESULTS

Some of the other major provisions that the Treasury did not take into account, in their examination of the President's tax proposal, are:

- . Lower marginal tax rates for individuals leading to smaller demand for tax-exempt bonds;
- . Limitation on individual's interest deductions makes other financial assets more attractive;
- . Elimination of interest deductions for banks will lower the demand for tax-exempt bonds;
- . Limitations on advance refunding of tax-exempt debt and tax arbitrage will reduce the volumes of tax-exempt bonds;
- . Elimination of the deductibility of state and local income taxes and individual's deduction for property tax payments will affect the market for tax-exempt bonds in several ways.

The many direct and secondary impacts of the above provisions, generally weaken the tax-exempt bond market. This results in a reduction of federal revenue gains from the elimination of selected tax-exempt bonds. It is also an incentive for investors not to stay in the tax-exempt bond market, and will increase short term financing costs in the market as a result of the lower marginal tax rates.

September 23, 1985

Riverboat Delta King, Inc.  
901 Tamalpais Avenue, Suite 200  
San Rafael, CA 94901

Dear Gentlemen:

On September 10, 1985, the Sacramento City Council adopted a Resolution No. 85-704 authorizing the execution of Agreement No. 85042 for mooring the Delta King in Old Sacramento.

Enclosed, for your records, is one fully certified copy of said agreement and authorizing resolution.

Sincerely,

LORRAINE MAGANA, CITY CLERK

Janice Beaman  
Deputy City Clerk

JB/dah/45  
Enclosure

cc: City Manager  
Risk Management