

APRIL 28—WORKERS' MEMORIAL  
DAY UNDERLINES IMPORTANCE  
OF OCCUPATIONAL SAFETY

**HON. JAMES T. WALSH**

OF NEW YORK

IN THE HOUSE OF REPRESENTATIVES

*Wednesday, May 5, 1999*

Mr. WALSH. Mr. Speaker, today I ask my colleagues to join me in recognizing April 28 as Workers' Memorial Day in the State of New York. This is a wonderful opportunity for us to remember an important issue in today's workplace, occupational safety.

Every city, town and village in this country was built by the proud efforts of working people. They have contributed to our Nation's wealth and reputation, our national defense and quality of life.

In some instances in the past, they have endured harsh and even perilous conditions in pursuit of excellence and their livelihood.

Today, we must continue the fight to ensure the safety of all workers. The sacrifices of the past will not be forgotten as we strive to eliminate dangers at the workplace.

I want to thank the working men and women of Central New York in particular for their invaluable contributions to our community.

CONSTRUCTIVE OWNERSHIP  
TRANSACTIONS

**HON. RICHARD E. NEAL**

OF MASSACHUSETTS

IN THE HOUSE OF REPRESENTATIVES

*Wednesday, May 5, 1999*

Mr. NEAL of Massachusetts. Mr. Speaker, today I am introducing legislation to prevent a transaction the goal of which is tax avoidance by means of converting ordinary income or short-term capital gains into income eligible for long-term capital gains rates.

Since Congress enacted legislation to lower the capital gains tax below that of ordinary income, the press has written about a number of transactions that have been developed to recharacterize income primarily for the avoidance of tax. Congress closed one loophole in 1997 involving constructive sales or so-called "short-against-the-box" transactions. In those transactions investors were effectively selling an asset and receiving the benefits of a sale without calling it a sale for tax purposes. The Taxpayer Relief Act of 1997 termed these transactions constructive sales and restored the appropriate tax treatment, determining that if it looks like a sale and acts like a sale, it should be treated as a sale for tax purposes.

Consistent with that approach, our former colleague Barbara Kennelly developed additional legislation in 1998 that could be termed "constructive ownership" legislation. In this case, an investor effectively purchases an asset and has the benefit of ownership, but does not pay taxes on income from the asset in the same way as if the investor owned it directly. The solution that was proposed was to treat that investment no more favorably than the treatment ownership in the underlying asset would have received. In addition, while this treatment would assure appropriate capital gains treatment, these transactions could still be attractive for deferring the recognition of ordinary income—in contrast to direct owners

who pay taxes annually on ordinary income. To correct this, the bill imposes a deferred interest charge to recapture the benefits of deferral.

As many in the industry will recognize, the legislation I am introducing today is based on the Kennelly bill, but makes several technical improvements which were suggested last year, primarily by the New York State Bar Association. Additional comments, of course, are certainly in order.

Investors in a hedge fund (and other pass through entities) are required to pay taxes annually on their share of the income from the fund regardless of whether they receive a distribution. In the transaction covered by the bill, investors indirectly invest in the fund through a derivative that is economically equivalent to a direct investment. However, the derivative allows the investor to defer his tax liability. Invest in a hedge fund, and you pay taxes every year, and those profits are taxed at the higher short-term capital gains rate. Place that same money in a derivative wrapped around a hedge fund, and you pay taxes only at the end of the contract, and the profit is taxed at the lower long-term capital gains rate. The bill I am introducing today states that if an investor indirectly owns a financial asset like a hedge fund through a derivative, they cannot get more long-term capital gain than if they owned the investment directly. In addition, there is an interest charge to offset the additional benefit of the deferral.

The effective date for this legislation is for gains realized after date of enactment. This is a more generous effective date than that contained in the Administration's budget. Still, some would argue that this is retroactive, because they signed contracts prior to the date of introduction of the Kennelly Bill and therefore were not on notice that a change in the law might occur.

Since I announced my intention to reintroduce the Kennelly bill, it is my understanding that a number of contracts have been, and continue to be, signed under the theory that the legislation may not pass Congress, and if it did the transaction could simply be unwound. This may explain the recent comments of Robert Gordon, President of 21st Securities, as reported in this month's edition of MAR/Hedge, which states: "Gordon says that the penalty is so low (in my legislation) that he would advise clients thinking about *synthetic hedges* (italics are mine) to go ahead. "There is not a lot of cost if the bill does become retroactive, you just unwind the swap." The penalty is the difference between the two interest rates—the one charged in the swap by the dealer and the interest rate earned by money in the investor's hands. Because the interest today and the interest rate when the law changes, say several months from now, will be relatively small, it is a small penalty to pay."

It is hard to be sympathetic to an investor who enters into a particular so-called "synthetic" transaction purely for purposes of tax avoidance. It is even harder to be sympathetic when the investor signs a contract after he was on notice that there was a legislative change under consideration. It is hardest of all to be sympathetic to an investor who deliberately signs a contract betting that the potential for tax avoidance far outweighs a potential loss attributed to unwinding a contract if the law does change, and then claims "retro-

activity" in a last attempt to secure the benefits of tax avoidance.

Nonetheless, the fact remains that some contracts were signed prior to the date of introduction of the Kennelly bill. I have therefore added a grandfather clause to this legislation that exempts all contracts from changes in this bill if the contracts were signed prior to the date of introduction of her bill on February 5, 1998. The grandfather clause would cease to exist if the contract was extended or modified.

Mr. Speaker, all capital gains differentials invite attempts to recharacterize ordinary income or short-term capital gains into long-term capital gains. The transactions I am talking about are, of course, not available to the ordinary investor who must pay his fair share of taxes, but only to a small number of sophisticated wealthy investors. Any perception that being sophisticated and wealthy enough allows some to avoid paying their fair share of tax undermines the entire tax system, as well as the capital gains differential. I believe it is important to shut down tax shelters as we uncover them, and if we in Congress do not have the courage to do that, then maybe allowing the Department of the Treasury to have broader power to characterize tax shelters and shut them down through the regulatory process needs to be seriously considered.

RECOGNIZING THE IMPORTANCE  
OF SMALL BUSINESS AND PAYING  
TRIBUTE TO THIS YEAR'S  
SMALL BUSINESS AWARD RECIPIENTS  
IN NEW HAMPSHIRE

**HON. CHARLES F. BASS**

OF NEW HAMPSHIRE

IN THE HOUSE OF REPRESENTATIVES

*Wednesday, May 5, 1999*

Mr. BASS. Mr. Speaker, I am pleased to have this opportunity to recognize several small business leaders from my home state of New Hampshire. As we all know, small businesses in the United States serve as the backbone of our economy, accounting for more than ninety-nine percent of America's employers and employing fifty-three percent of America's workforce. The role of small businesses, especially in New Hampshire, is essential in strengthening our economy, expanding opportunities for employers and employees, and providing goods and services that are second to none.

This year, five individuals from New Hampshire have been recognized by the U.S. Small Business Administration for their exemplary contributions to small business in New Hampshire. In addition, 1999 marks the thirty-fifth anniversary of the Service Corps of Retired Executives (SCORE) and the fifteenth anniversary of the New Hampshire Small Business Development Center. At the annual "New Hampshire's Salute to Small Business" dinner and awards ceremony, these two groups and the following individuals will be honored for their overall promotion of small business and for their individual successes during the past year:

Frederic A. "Rick" Loeffler, CEO of Shorty's Mexican Roadhouse in Manchester, will be presented with the New Hampshire Small Business Person of the Year Award;

Christine Gillette, business and economic development editor of the Portsmouth Herald,