DESCRIPTION OF S. 1787

(ASSET DISPOSITION AND REVITALIZATION CREDIT ACT OF 1991)

Scheduled for a Hearing

Before the

SUBCOMMITTEE ON TAXATION

of the

SENATE COMMITTEE ON FINANCE

on October 22, 1991

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The Subcommittee on Taxation of the Senate Committee on Finance has scheduled a public hearing on S. 1787 ("Asset Disposition and Revitalization Credit Act of 1991") on October 22, 1991. The bill was introduced on October 1, 1991, by Senator Breaux (along with Senator Kerry) and is intended to encourage the sale of real property held by the Resolution Trust Corporation by amending the Internal Revenue Code to allow a general business credit against the income tax of purchasers of such property. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of the present-law rules pertaining to certain tax credits and the provisions of S. 1787 and an analysis of certain economic effects of the bill.

Part I of the document is a summary of the pamphlet and provides certain background information. Part II is a description of certain present-law rules relating to tax credits. Part III is a detailed description of S. 1787. Part IV is an analysis of certain issues raised by the bill.

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[1] This document may be cited as follows: Joint Committee on Taxation, Description of S. 1787 (Asset Disposition and Revitalization Credit Act of 1991) (JCX-23-91), October 21, 1991.

I. SUMMARY AND BACKGROUND

Overview

On October 1, 1991, Senator Breaux, along with Senator Kerry, introduced S. 1787, entitled the "Asset Disposition and Revitalization Credit Act of 1991." The bill is intended to encourage the sale of real property held by the Resolution Trust Corporation (RTC) by amending the Internal Revenue Code to allow a general business credit against the income tax of purchasers of such property (the "RTC property credit"). Certain provisions of the proposed RTC property credit are similar to provisions of the present-law low-income housing tax credit.

Brief description of the bill

In general, the bill provides an aggregate of $1 billion of tax credits that the RTC may allocate to taxpayers in order to facilitate the disposition of real property in 1992 and 1993. The credits generally would be spread in equal installments over a 5-year period beginning with the year of the acquisition of qualified property. Under the bill, the RTC must allocate the lowest amount of credit to a property as is necessary to sell such property at the lowest price acceptable to the RTC. In no event may the present value of credits attributable to any acquisition of property exceed 80 percent of the purchase price of the property plus estimated rehabilitation and completion costs.

The bill also provides other special rules and limitations with respect to the credit. For example, the credit would be unavailable to certain persons previously associated with a failed depository institution or who had had an interest in the property. The present value of the credit could not exceed the taxpayer's equity investment in the property. In addition, the amount of the allowable credit is reduced if the taxpayer receives a Federally-funded grant with respect to the property. Upon the disposition of credit-eligible property, twenty percent of the gain would be paid to the RTC and would be excluded from the gross income of the taxpayer. A portion of the credit would be recaptured if certain estimated rehabilitation and completion costs of the property are not incurred.

The bill makes the RTC property credit a component of the general business credit, but provides more liberal limitations on the utilization of the RTC property credit than are provided for the general business credit under present law. In addition, the bill provides an exception from the passive loss rules for a certain amount of the credit.

Background information

As of July 31, 1991, the RTC had control over 166 institutions in conservatorship and 467 institutions in receivership. Conservatorship institutions under RTC control had gross assets of $73.1 billion of which $7.2 billion was real estate. Receivership institutions under RTC control had gross assets of $82.5 billion of which $12.1 billion was real estate.[2]

Summary of analysis of the bill

The proposed RTC property credit to some degree would increase the saleability of RTC assets and increase RTC receipts. However, it is unlikely that this would result in a net gain in Government receipts, and any benefits of the proposal could probably be more efficiently achieved through non-tax provisions. This is the case because acquirors of RTC property generally would not value tax benefits more than cash. In addition, the proposed RTC property credit may result in an inefficient allocation of capital.

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2 Testimony of L. William Seidman, Chairman, Resolution Trust Corporation, Before the Subcommittee on Financial Institutions Supervision, Regulation and Insurance of the Committee on Banking, Finance, and Urban Affairs, House of Representatives, September 12, 1991.

II. PRESENT LAW

General business credit

Taxpayers are allowed to offset all or a portion of their tax liabilities with certain tax credits, including the general business credit. The components of the general business credit are (1) the investment credit,[3] (2) the targeted jobs credit, (3) the alcohol fuels credit, (4) the research credit, (5) the low-income housing credit, (6) the enhanced oil recovery credit, and (7) in the case of an eligible small business, the disabled access credit.[4] The general business credit generally may not reduce a taxpayer's net income tax liability below the greater of (1) the taxpayer's tentative minimum tax liability for the year, or (2) 25 percent of so much of the taxpayer's regular tax liability that exceeds $25,000. The portion of the general business credit not utilized in a taxable year generally may be carried back 3 years and carried forward 15 years.

There are no tax credits or other special provisions in the Internal Revenue Code (Code) relating to the acquisition of property from the RTC.

The low-income housing tax credit

A tax credit is allowed in annual installments over 10 years for qualifying low-income rental housing, which may be newly constructed or substantially rehabilitated residential rental property. For most newly constructed and rehabilitated housing placed in service after 1987, the credit percentages are adjusted monthly to maintain a present value of the credit of 70 percent of the total qualified expenditures. In the case of newly constructed or rehabilitated housing receiving other Federal subsidies (including tax-exempt bonds), monthly adjustments are made to maintain a 30-percent present value of the credit.

A residential rental project qualifies for the

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[3] The investment credit generally was repealed by the Tax Reform Act of 1986. The investment credit is still available for certain rehabilitation expenditures, certain reforestation expenditures, and the acquisition of certain energy property.

[4] The research credit, the low-income housing credit, the targeted jobs credit, and the energy property portion of the investment tax credit are scheduled to expire after December 31, 1991.

low-income housing credit only if (1) 20 percent or more of the aggregate residential rental units are occupied by individuals with incomes of 50 percent or less of area median income, as adjusted for family size, or (2) 40 percent or more of the aggregate residential rental units in the project are occupied by individuals with incomes of 60 percent or less of area median income, as adjusted for family size. Credit eligibility also depends on the existence of a 30-year extended low-income use agreement for the property. If property on which a low-income housing credit is claimed ceases to qualify as low-income rental housing or is disposed of before the end of an initial 15-year credit compliance period, a portion of the credit is recaptured. The 30-year extended use agreement creates a State law right to enforce low-income use for an additional 15 years after the initial 15-year compliance period.

In order for a building to be a qualified low-income building, the building owner generally must receive a credit allocation from the appropriate credit authority. An exception is provided for property which is substantially financed with the proceeds of tax-exempt bonds subject to the State's private-activity bond volume limitation. The low-income housing credit is allocated by State or local government authorities subject to an annual ceiling for each State. The annual credit ceiling for any State is $1.25 per resident per year.

The passive loss rules of Code section 469 limit losses and credits derived from passive trade or business activities of the taxpayer. Such losses and credits generally may not be applied against income (or tax attributable to income) such as wages, portfolio income, or business income that is not derived from a passive activity. A special rule, however, allows individual taxpayers to utilize the deduction-equivalent amount of up to $25,000 of low-income housing credits in any taxable year.

III. DESCRIPTION OF S. 1787

General determination of the amount of the credit

The bill would add an "RTC property credit" as a component of the general business credit. The amount of the allowable RTC property credit would be equal to the applicable percentage of the qualified basis of each qualified RTC property held by the taxpayer at any time during the taxable year. The credit generally would be determined for the taxable year the property is acquired by the taxpayer from the RTC and each of the four succeeding taxable years.

For purposes of determining the amount of the RTC property credit, the "applicable percentage" would mean a percentage determined by the Secretary of the Treasury that would yield, over a 5-year period, amounts of credit that have a present value equal to not more than 80 percent of the qualified basis of the property acquired by the taxpayer from the RTC. The percentage would be determined for the month during which the property was acquired pursuant to rules similar to those of Code section 42(b)(2)(C) of present law.[5] The term "qualified basis" would mean the sum of (1) the unadjusted basis[6] of the property that is attributable to its acquisition by the taxpayer from the RTC, plus (2) the estimated cost to the taxpayer of rehabilitating or completing the property or project, if necessary. These estimated costs must be determined by agreement between the taxpayer and the RTC.

"Qualified RTC property" means any real property that is acquired by the taxpayer from the RTC in connection with the

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[5] Section 42(b)(2)(C) provides that, for purposes of the low-income housing credit, present value is determined: (1) as of the last day of the first year of the period over which the credit is allowed; (2) by using a discount rate equal to 72 percent of the average of the annual Federal mid-term and long-term rates applicable under section 1274(d)(1) of the Code for the applicable month; and (3) by assuming the allowable credit is received on the last day of the year.

[6] For this purpose, the "unadjusted basis" would be determined without taking into account the reductions to basis provided by section 1016(a)(2) and (3) of the Code for depreciation, amortization, and depletion allowances. A similar definition applies for purposes of the present-law low-income housing credit.

disposition or liquidation of the assets of a depository institution.[7] In addition, in order for a property to be qualified, the RTC must certify that (1) after making reasonable efforts, it is unable to sell the property at a price permitted by law without offering the RTC property credit, and (2) deferring the sale of the property is not likely to result in a sufficiently higher sale price to fully compensate the RTC for the estimated additional costs resulting from the deferral of the sale.

<u>Certain limitations on the amount of credit</u>

In addition to the computational and certification provisions described above, the bill provides other limitations on the amount of credit allocable to a property.

First, the amount of credit with respect to any qualified RTC property for any taxable year could not exceed the amount the RTC allocates to such property before its sale. The aggregate amount of credit that the RTC may allocate to all properties may not exceed $1 billion.

Second, the applicable percentage used in determining the credit may not exceed the percentage specified by the RTC for the property that produces the lowest amount of credit necessary to sell the property at the lowest price acceptable by the RTC. The RTC would make this determination after taking into account all other benefits, regardless of source, provided in connection with the purchase of the property.

Third, the present value of the credit allowable to a taxpayer with respect to a property may not exceed the taxpayer's equity in the property. Such equity would be measured by the excess of (1) the taxpayer's cost of acquiring the property from the RTC over (2) the amount of any loan made by the RTC (reduced by the amount of any other property pledged by the taxpayer for such loan).

<u>Additional special rules</u>

In addition to the above potential limitations on the amount of credit allowable, the bill provides additional special rules.

The qualified basis of a qualified RTC property would be reduced by the portion of any grant made with respect to the property that is Federally funded. The reduction in qualified basis would apply for the year the grant is made

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7 It is understood that the term "qualified RTC property" is intended to include any real property acquired by the taxpayer from a depository institution under RTC receivership or conservatorship.

and all subsequent years.

The credit would not be allowed to any taxpayer who at any time (1) was an officer, director, or substantial shareholder in any depository institution the assets of which were acquired by the RTC or (2) held a substantial ownership interest in the assets acquired by the RTC. For this purpose, a "substantial shareholder" would mean any person who directly (or indirectly through attribution) owns five percent or more of the stock of a depository institution. A "substantial ownership interest" would be any interest that entitles the holder to five percent or more of the net income or gain with respect to the property. Property held by a partnership, trust, or estate generally would be treated as owned proportionally by its partners or beneficiaries. However, any interest as a general partner would constitute a substantial ownership interest.

If the qualified basis of a property is determined with reference to estimated rehabilitation or completion costs and such costs are not incurred by the end of the second year following the year of the acquisition of the property, the qualified basis of the property would be reduced by the amount of the estimated costs not incurred. In addition, the taxpayer would increase its tax liability by the excess of the amount of credit allowed for the preceding taxable year over the amount that would have been allowed using the recomputed unadjusted basis.[8] The basis adjustment and recapture rules may be applied with respect to any property by using any later date specified by the RTC.

Under the bill, Code section 1274 would not apply to any loan made by the RTC. Under present law, section 1274 generally provides that the issue price of a debt instrument that is issued as consideration for property and that does not have adequate stated interest is determined by discounting the payments due under the instrument by the applicable Federal rate. The payments due under the instrument are then recharacterized and treated as either principal or interest under the present-law original issue discount rules.[9]

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8 It appears that the taxpayer would not be required to recapture any credit applicable to the year the property was acquired.

9 The application of this special rule in the context of the bill is unclear. In a limited sense, it may be intended to provide that if the RTC seller-finances the sale of a property to a taxpayer, the taxpayer's basis of the property for purposes of determining the amount of credit allowable would be determined with respect to the face amount of the
(Footnote continued)

The amount of credit allowed to a taxpayer in year the property is acquired or disposed of would be determined by multiplying the full amount of credit otherwise allowable for the year by a fraction, the numerator of which is the number of full months the taxpayer held the property during the year and the denominator of which is 12. The amount of any reduction of the otherwise allowable credit applicable to the year of the acquisition of the property would be taken into account in the fifth year thereafter.[10]

<u>Treatment of subsequent dispositions of qualified RTC property</u>

If any qualified RTC property is sold, exchanged, or otherwise disposed of by the taxpayer during the taxable year, the taxpayer would pay an amount equal to 20 percent of the gain to the RTC. For this purpose, the amount of gain would be the difference between (1) the amount realized (in the case of a sale, exchange or involuntary conversion) or the fair market value of the property (in the case of any other disposition), and (2) the unadjusted basis of the property (reduced by the expenses paid or incurred in connection with the disposition.) The Secretary of the Treasury would be authorized to prescribe regulations for the treatment of transactions described in the nonrecognition provisions of the Code. The amount of gain to be paid to the RTC would not be includible in the gross income of the taxpayer.

Any payment required to be made to the RTC under this provision may be enforceable by lien or other measures deemed appropriate by the RTC. The payment requirement would not be construed as giving the RTC or the United States any ownership interest in the RTC credit property as long as the required payment is made.

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[9] (continued)
loan (assuming the taxpayer pledges other property for the repayment of the RTC loan). This would have the effect of the taxpayer receiving tax credits for a portion of amounts that would otherwise be characterized as interest (as opposed to principal) under the original issue discount rules of present law. In a broader and more literal sense, the special rule may be intended to provide that the original issue discount rules of the Code do not apply for purposes of any RTC loan, regardless of whether the loan is made in connection with a sale of a property eligible for the RTC property credit.

[10] It is unclear whether the taxpayer must still hold the property in this sixth year in order to claim this residual amount of credit.

<u>Coordination of the RTC property credit with other provisions of the Code</u>

The RTC property credit would be made part of the general business credit. However, no portion of an unused general business credit that is attributable to the RTC property credit may be carried back to a taxable year ending before the enactment of RTC property credit.

For a subchapter C corporation, the present-law tax liability limitations applicable to the utilization of general business credit would be separately applied to the taxpayer's general business credit (determined by not including the RTC property credit) and the RTC property credit. This separate application of the limitation would potentially allow a C corporation to utilize a greater amount of total credits than if the RTC property credit were combined with the other general business credits for limitation purposes. For taxpayers other than C corporations, the RTC property credit may reduce up to 50 percent of the taxpayer's net chapter 1 tax for the year. A taxpayer's "net chapter 1 tax" would be defined as the sum of the taxpayer's regular and alternative minimum tax liability reduced by credit allowed against such liability (other than the credit allowed by Code section 34 and the RTC property credit).

The bill provides an exception from the passive activity rules of Code section 469 for up to $50,000 of RTC property credit for a taxpayer for any taxable year.

<u>Effective dates</u>

The RTC property credit provisions would apply to taxable years ending after December 31, 1991, with respect to property purchased from the RTC (1) after December 31, 1991 and before January 1, 1994, or (2) after December 31, 1993, if pursuant to a binding contract in effect on December 31, 1993.

IV. ANALYSIS OF ISSUES

Incentive for new capital formation and for the sale of existing assets

The RTC property credit has two parts: (1) a credit for expenditures for the rehabilitation and completion of property and projects purchased from the RTC and (2) a credit for purchase of RTC property. Besides potentially increasing the saleability of existing assets, the first part of the RTC credit might be viewed as an incentive for capital formation since it provides tax credits for investment in the form of expenditures on rehabilitation and completion.

The second part of the RTC property credit is intended to be an incentive to help the RTC sell existing assets. To the extent the RTC property credit applies to existing assets, it should be distinguished from other business credits which are intended to promote capital formation. Except for one component of the low-income housing credit (which requires substantial rehabilitation of existing assets), tax credits under present law generally do not apply to expenditures for purchase of existing assets.[11] In addition, the repealed investment tax credit generally did not apply to the purchase of existing assets.

Since the RTC property credit may be considered, in part, a credit to increase expenditures on new capital, it may be useful to evaluate the evidence on other credits intended to increase capital expenditures. In general, there is considerable uncertainty about the effectiveness of tax credits for increasing investment. Proponents of business credits argue that they are necessary to maintain or to increase the level of those types of capital expenditures that qualify for the credits. Critics argue that, in general, taxes have limited impact on business and financial decisions and that these credits in particular are merely rewarding activities which would have occurred otherwise. Furthermore, if there is any increase in qualifying expenditure, it is at the expense of reductions in other type of similar expenditures not qualified for tax credits.[12] The

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[11] For example, tax credits for are currently available for capital expenditures on new capital in the form of low-income housing, disabled access, rehabilitation of certain structures, acquisition of certain energy property, and certain reforestation expenses.

[12] For example, it has been argued that any increases in (Footnote continued)

empirical evidence on the effectiveness of business tax credits is inconclusive.[13]

Factors determining the net impact on Government receipts

The credit for the purchase of existing RTC property is intended to increase sales of RTC property. Because a purchaser of RTC property receives a tax credit, the effective price of the RTC property is reduced.[14] For example, assume a property held by the RTC has a fair market value of 20 without a tax credit. With the availability of a tax credit with a present value of 80, under certain conditions, the RTC might be able to raise the sale price to 100. However, the additional 80 of Government receipts from the sale of RTC property is offset by the 80 reduction in tax revenue. Therefore, in this best case, the effect of this tax provision on Government receipts is zero, and the property is sold for the net price of 20, regardless of whether the credit is provided.

However, it may be that the RTC is not selling property because it has set prices too high. In the above example, assume the RTC attempts to sell the same property for the

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[12](continued)
expenditures for qualified capital equipment attributable to the investment tax credit were primarily the result of substitution from structures (generally not qualified for the credit) to equipment.

[13] There has been substantial empirical work undertaken to assess the effectiveness of the investment tax credit. The results are inconclusive. For example, see Dale W. Jorgenson, "Econometric Studies of Investment Behavior: A Survey," Journal of Economic Literature, Vol. 9, December 1971 and Robert Eisner, "Econometric Studies of Investment Behavior: A Comment," Economic Inquiry, Vol. 12, 1974, pp. 91-103. Relative to the amount of research on the effectiveness of the investment tax credit, there is only a small amount of research on the effectiveness of other tax credits. Although some studies discuss their effectiveness, few provide econometric evidence. With regard to the research tax credit and energy tax credits, the little evidence there is suggests that they do not increase incentives. See, for example, Robert Eisner, Steven Albert, and Martin A. Sullivan, "The New Incremental Tax Credit for R&D: Incentive or Disincentive?" National Tax Journal, Vol. 37, No. 2, June 1984; and U.S. General Accounting Office, "Additional Petroleum Production Tax Incentives are of Questionable Merit" (GAO/GGD-90-75), Washington D.C., July 1990. Similarly, there is some evidence that the targeted
(Footnote continued)

price of 100 because this is its appraised value. However, the RTC would not be able to sell the property because its true value is 20. With a tax credit equal in present value to 80 percent of the purchase price, the RTC might be able to sell this property for 100. Although the Government in this case receives 100 for the property, and pays out 80 in credits, the Government also has also disposed of 20 of property. Thus, there is no effect on the government's net worth. Furthermore, without any amendment to the Internal Revenue Code, the RTC also would be able to achieve at least as favorable an outcome by selling the property without a tax credit for a price of 20.[15] As discussed below, a tax credit will generally be less attractive to investors than a price reduction of equal value. Therefore, tax credits generally will be more costly to the Government than price reductions providing the same benefit to investors.

Effects of the RTC property credit on the sales price of RTC property

Proponents of the RTC property credit may argue that the credit would increase net Federal Government receipts because revenue lost from the tax credit would be offset by higher prices received by the RTC upon the sale of qualified

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[13](continued)
jobs credit has had little effect on increasing employment. See, Linda LeGrande, "The Targeted Jobs Tax Credit, 1978-1987," Congressional Research Service, Report for Congress (87-616 E), July 14, 1987; Robert Tannenwald, "Are Wage and Training Subsidies Cost-Effective?--Some Evidence from the New Jobs Tax Credit," New England Economic Review, September/October 1982, pp. 25-34; and John H. Bishop and Suk Kang, "Applying for Entitlements: Employers and the Targeted Jobs Tax Credit," Center for Advanced Human Resource Studies, Cornell University, Working Paper #88-04, February 9, 1988. For discussions of the low-income housing credit and the rehabilitation tax credit, respectively, see, for example, ICF Incorporated, "Evaluation of the Low-Income Housing Credit--Final Report," U.S. Department of Housing and Urban Development, Office of Policy Development and Research, February 1991; and Betsy Chittenden, "Tax Incentives for Rehabilitating Historic Buildings: Fiscal Year 1988 Analysis," U.S. Department of the Interior, National Park Service, November, 1988.

[14] This description of the RTC property credit in this paragraph assumes that the RTC will set prices low enough to sell its property. There is at least one report that this is the RTC's practice. See Paulette Thomas, "Resolution Trust Corporation Makes Some Headway in Selling S&L Assets," Wall Street Journal, October 3, 1991. If, however, the RTC does

(Footnote continued)

properties. Although it is correct (as discussed above) that there is likely to be some offset, it is implausible that these offsetting receipts would be sufficient to result in a net positive impact on the budget deficit. On the contrary, as described below, it is likely that the credit will result in a reduction in Federal Government receipts.

It is possible for any price subsidy to increase price by the full present value of that subsidy. However, this would require the entire amount of the benefit of the subsidy to flow to the seller. This is likely when there is a fixed supply of assets eligible for the credit and a large number of potential buyers.[16] The relatively inelastic supply of RTC real property suggests that the benefit of the RTC property credit may accrue largely to the RTC in the form of higher prices.

However, it could be the case that, for reasons not associated with maximizing profit or because of financing constraints, the RTC may be anxious to sell some properties quickly once a certain minimum sales price is realized. Furthermore, because the real estate market is highly heterogeneous, there may not be large demand for any particular property sold by the RTC. In this case, the RTC is not in as strong a bargaining position, and may not be able to capture the full value of the credit. As a result,

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[14](continued)
not reduce prices sufficiently to sell properties (as described in the following paragraph), the efficiency of the credit may be equivalently evaluated in terms of cost of the credit relative to price reductions. The discussion below suggests that in order for a tax credit to be as effective as a price reduction of 80 the credit must have a present value of greater than 80.

[15] Although the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 restricted the ability of the RTC to reduce price of purchased assets substantially below their appraised values, these restrictions have been relaxed recently. Price reductions by the RTC equal to the amount of credit could largely achieve the same effect on sales as availability of a tax credit.

[16] In economics terminology, the division of the benefit of a tax credit (or of the burden of a tax) is referred to as the "incidence" of the benefit (or tax). The incidence of a tax effect, in a partial equilibrium analysis, depends on the relative size (in absolute value) of the elasticities of supply and of demand. If, for example, supply is totally inelastic and demand is infinitely elastic, the benefit of a tax credit will accrue entirely to the seller who may raise the price by the entire value of the credit.

the prices of the RTC property will not rise by as much as the value of the credit, and the net impact on Government receipts will be negative.

Other factors limiting price increases

The passage above argues that because buyers have some market power, it may be possible that the price of RTC property would not rise by the full amount of the credit, and that buyers may be able to capture some benefit of the credit. In addition, there are several other factors that reduce the attractiveness of the credit and may drive the value of the credit to purchasers below its cost. First, because there are some costs in applying for the credit and complying with rules pertaining to the credit, a purchaser may value these benefits at less than their cost to the Government. Second, the taxpayer may discount these benefits because of uncertainty about future changes in law which may diminish the benefits of the credit,[17] or because of uncertainty as to whether income tax liability to which the credit may be applied will exist in future years, or because there is some probability that a purchaser will have to sell the property and not receive the credit. For example, suppose because of a variety of factors, a buyer expected that only one half of the allowable credits of 100 would ever be utilized, and suppose that this turns out to be correct. Although the expected value to potential buyers is 50, and the cost to the government is 50, potential buyers may be willing to accept the risk associated with tax benefits only with some discount for the uncertainty. Therefore, taxpayers might, for example, only pay 45 for tax benefits with an expected present value of 50.

Administrative cost of the credit

In addition to reduced tax receipts, the net effect on government receipts may be adversely affected by the increased costs incurred by the Internal Revenue Service and the RTC to administer this credit.

Distortions in the allocation of capital

The RTC property credit may distort the allocation of capital by providing tax incentives that favor real property sold by the RTC over other real property. For example, suppose a business was deciding between two sites for the location of a warehouse. One site, owned by a private investor, might be superior from the perspective of the

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[17] For example, the individual alternative minimum tax might be modified to include the proposed credit as a preference item.

prospective purchaser to a second site, owned by the RTC, because the former is located closer to suppliers and customers. However, if the business were able to capture some of the tax benefits associated with the RTC property, the business might select an RTC property with the less advantageous location because of the availability of tax benefits.

Capital also may be misallocated because the tax credit may have different values to different prospective purchasers. Returning to the previous example, two competing businesses may be considering the purchase of a warehouse owned by the RTC. The first business is part of a consolidated group with large tax liabilities which is considering entering a new line of business. The second business is a start-up firm which, because of large capital expenditures and gradual market development, has no prospect of positive income tax liabilities for many years. Even if this start-up business were more efficient and could make better use of the property, the property might be purchased by the consolidated group since tax credits provide the start-up business with a relatively smaller benefit.