Valuation of Safe Harbor Tax Benefit Transfer Leases: Discussion
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4. John T. Rowntree and Earl R. Rolph, "Efficient Community Management," forthcoming in *Studies in Public Sector Economics*, JAT Press, Vol. I.
5. Jon C. Sonstelie and Paul R. Portney, "Profit Maximizing Communities and the Theory of Local Government Expenditures," *Journal of Urban Economics* 5 (April 1978), 263–77.

DISCUSSION

HAROLD BIERMAN, JR*: Basically, I liked the Fabozzi and Yaari paper and have no major criticisms. However, I do have several observations.

First, the authors should have noted the multiple internal rate of return nature of the cash flows presented in Table 1. While this is not a criticism of the authors in the current paper because they correctly illustrated the calculations using the net present method, it could be important if a practitioner computed the lessor's internal rate of return and found it to be less than .05, thus rejected the investment. The fact that another internal rate of return in excess of .35 exists might pass unnoticed.

Good examples of multiple rates of return are hard to find. We teachers cannot afford to let one pass without notice.

Secondly, while safe harbor leasing has effectively been killed by the tax act of 1982, and it would seem that safe harbor leasing is not a high priority, we should not jump to that conclusion. The 1982 tax act has defined "finance leases" to start in 1984 and finance leases will be very similar to safe harbor leases.

The third comment is of more importance than the first two. It arises not because of anything that Fabozzi and Yaari said, but rather about what was not said.

The safe harbor tax provisions effectively allowed the sale of tax credits and tax deductions from one entity to a second entity. The entity selling the tax shields was not likely to be paying taxes and the entity buying the shields was likely to be paying marginal taxes at a .46 rate.

Congress' apparent objective in passing this legislation was to give a tax break to those firms that were having tax losses and that were not able to use the tax shields directly. Prior to ERTA if such a firm bought an asset for $1,000,000 this was the cost. If a profitable taxable firm bought the asset, the net cost and thus the risk was reduced by investment tax credits and depreciation tax deductions.

If one believes in offering the underdog a hand, then one can be sympathetic with the objective of the 1981 act. However, let us consider the merits of the device chosen to achieve the objective.

If the tax shields associated with $1,000,000 of new equipment have a present value of $0 to a zero tax investor and a value of $480,000 to a firm paying taxes then with no other complexities (which are covered nicely by Fabozzi and Yaari) the firm purchasing the tax deductions (the lessor) would like to buy the deductions for $0 but would be willing to pay more than $0. The benefits will be split between the lessee, the lessor, and any third parties (middlemen and lawyers)

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who are paid for introducing the lessee and lessor and structuring the tax transfer leasing deal.

A study prepared by the staff of the Joint Committee on Taxation of Congress using leasing data for 1981 and two months of 1982 showed that on the average the lessee will receive approximately 76% of the benefits that Congress intended for them to have (or did Congress intend to reduce the taxes of profitable firms and supply employment for lawyers?) before considering any fees paid by lessees to third parties.

A simple solution exists for increasing the percentage of benefits that the lessee will receive.

If Congress wants to make it easier for firms with tax losses to purchase equipment then offer an investment allowance to all investors in real plant and equipment. If the present value of the tax deductions is computed to be $480,000 let the investors choose between the deductions and receiving a check from the U.S. Treasury for some amount less than $480,000 but not so much less that there is profit in structuring deals such as safe harbor leases. The firm would sell its tax deductions to the Treasury rather than to a profitable firm which then reduces its tax bill. The cost to the Treasury will be reduced and the targeted benefits will increase.

In their example, Fabozzi and Yaari computed the maximum amount the lessor could pay to be $190,600. The U.S. Treasury could set this as the minimum amount that they would offer (transactions costs would be saved if nothing else).

A critic of these comments could object to the Government offering any investment incentive. Remember, the issue being discussed is, *if* an incentive is to be offered, in what form should it be.

The 1982 tax act (TEFRA) raises many more issues than it solves. Why is the use of finance leases delayed to 1984 (the year may have Orwellian significance)? Will they be desirable in 1984 and not in 1983? Will firms be allowed to structure finance leases to resemble safe harbor leases (with a few curves added)? Why are public utilities and tax exempt institutions excluded? Why can a lessee only use finance leases for a limited proportion of its assets? Why limit the amount of finance leases a lessor can contract? Why require the investment tax credit to be written off over five years? Why doesn't Congress write leasing legislation that is logically consistent?